

INVEST IN GEORGIA

Since the peaceful "Rose Revolution" of November 2003 Georgia has appeared under the world spotlight as our new government took a solemn pledge to replace the years of frustration and dissolution with a new sense of hope and unity; to build a democracy that could embrace and protect all members of the Georgian nation.

The openness of Georgian economy to the world is the only feasible way to compensate for the lost opportunities of the last decade and a half of political turmoil, reversed reforms and indecisive government, and to fully utilize the economic potential of the country and its talented and hard working people. Anti-corruption measures, launch of privatization, liberalization of tax code, a package of new liberal business-related legislation, improvement of fiscal administration, higher level of institutional efficiency, independent judiciary - altogether provide for a substantially new business environment in Georgia. Environment, where private entrepreneurs – both foreign and Georgian – are equally protected from abuse and intervention from public authorities; taxes are reduced to the level unprecedented in the former Soviet Union; property rights, repatriation of capital, protection of investments are guaranteed by law; tax and customs procedures are simplified and liberalized; regulatory functions and procedures are reduced to the minimum and simplified; clearly formulated laws are enforced and not subject to discretion by state officials; fair and timely dispute resolution can be effectively sought in the courts at the national and international level; and intervention of the state into private business is minimized.



Growing economy, macroeconomic and financial stability increase the level of predictability in business operations. Geographic advantage of Georgia as the link between the markets and regions implies an array of potential projects in communications and transportation of energy, goods and materials. Dynamic growth in various sectors of economy and availability of traditional and potential markets, together with favorable trade regimes, and educated work force make Georgia an attractive production platform.

Georgia is open to foreign investors and partners. We are at the very beginning of the process of establishing long-term international business partnerships, which will make Georgia a regional hub of international business activity.

A stylized, handwritten signature in black ink, which appears to read "M. Saakashvili".

Mikheil Saakashvili
President of Georgia



GEORGIA AT A GLANCE

An Overview

country's territory and cover 2.7million hectares (6.6 million acres).

CLIMATE

Almost all climatic zones existing in the world, from the humid subtropical to eternal snow and icy peaks are represented in the comparatively small territory of Georgia.

Georgia's location between moderately humid Mediterranean and dry continental Arab-Caspian areas influences its climate. A humid sub-tropical climate dominates in Western Georgia.

In July the average temperature reaches $+24.4^{\circ}\text{C}$, in January the average temperature is $+10^{\circ}\text{C}$. In Eastern Georgia the temperature for the coldest month, January, varies from $+3^{\circ}\text{C}$ to -2°C . The average temperature in August, the warmest month is $+23^{\circ}\text{C}$ – $+26^{\circ}\text{C}$. In the sea-side areas of the Western Georgia mean annual precipitations vary from 1000 to 2800mm (in the mountains).

Form of government: democratic Republic.

Head of State: President – elected for a term of 5 years.

Branches of government: Parliament – 235 members elected for a term of 4 years; (Executive) Government – Prime Minister, Ministers, State Ministers – appointed by the Parliament; Independent Judiciary.

Territorial-administrative division: 9 regions (Guria, Imereti, Kakheti, Kvemo Kartli, Mtskheta-Mtianeti, Racha-Lechkhumi and Kvemo Svaneti, Samegrelo and Zemo Svaneti, Samtskhe-Javakheti, Shida Kartli), 9 cities, and 2 autonomous republics.

Current population: 4.4 million.

GEOGRAPHY

The country is situated in the south of the Caucasus region and occupies 69,700 sq.km. Georgia borders with Russia in the north, Azerbaijan in the south-east, Armenia in the south, Turkey in the south-west and the Black Sea in the west. The total length of its borders is 1 968.8km, of which 1 660.4 km is border land. Bordering countries and length of borders: Armenia 164 km, Azerbaijan 322 km, Russia 723 km, Turkey 252 km

LANDSCAPE

Georgia is distinguished by its complex and varied relief. The north is dominated by the mountains of the Great Caucasus Range, while Southern Georgia is traversed by the South Georgian Plateau. From the shore of the Black Sea in the west to the Alazani Valley in the east run the inter-mountain lowlands of Georgia. The mountain range Rikoti divides the country into two parts differing in climate: Eastern Georgia and Western Georgia. The highest peak is Shkhara (5068m), the lowest place (-1.5 m) is the environs of lake Paliastomi in the Kolkhети Lowland. Forests constitute 38% of the



HISTORY

The oldest remains of *homo erectus* in Western Eurasia (approximately 1.8 million years old) recently discovered



in Georgia only support the consensus among scholars that humans have inhabited the territory of Georgia since the very dawn of the human race.

Georgians first appear in written history in the 12th century B.C. Archaeological finds and references in ancient sources reveal the brilliance and advancement of early Georgian political and state formations – their amazing urban heritage and cutting-edge metallurgy and goldsmith techniques that date back to the 7th century B.C. and beyond. In the 4th century B.C. a unified kingdom of Georgia – an early state of advanced state organization under one king and the hierarchy of aristocracy was established.

Christianity came to Georgia with its first missionaries and it was declared the state religion as early as in 337 A.D. Early and medieval Christian scholarship, the links with the rest of the Christian world, and dynamic exchange with the Islamic world, together with the development of national literature and the political consolidation of the state in the 11th century A.D. culminated in a true renaissance in the 12-13th centuries A.D. Early Georgian renaissance that preceded its European analogue by several hundred years, was significant with its magnificent secular art and culture, the flourishing of a romantic-chivalric tradition, breakthroughs in philosophy, and an array of political innovations in society and state organization including religious and ethnic tolerance, the abolition of death penalty and a proto-parliament.

The Golden age of Georgia left a magnificent legacy of great cathedrals, brilliant romantic poetry and literature, and the epic poem “The Knight in the Panther’s Skin” – revered by all Georgians since its creation for its artistic and philosophical virtue, and the glorification of the ideals of universal solidarity between humans, and the values of chivalry, honour,

compassion and romantic love. This Golden Age was interrupted at its peak by the Mongol Invasion in the 13th century A.D. Since then, the Georgian feudal state entered an era of decline punctuated by short-lived ascents.

In the 19th century, Georgia, at the verge of annihilation by its powerful southern rivals, was annexed by the Russian Empire. A few decades later, Georgian society produced a modernist nationalistic elite which united Georgian society around the dream of the restoration of their once glorious state. In 1918, this dream was fulfilled and the Democratic Republic of Georgia was established. This courageous democratic experiment was short-lived, as in 1921 Georgia was occupied by the Bolshevik Russia.

The first years of independence after the dissolution of the USSR were characterized by political instability and civil conflicts. The first wave of reforms initiated in 1995 was only partially successful. Political corruption resulted in economic decline and institutional inefficiency, which led to a grave political crisis. In November 2003, the “Rose Revolution” – a mass non-violent public disobedience campaign – forced the government that tried to falsify elections to resign. The new wave of systemic reforms started after the election of the new Government.

PEOPLE AND LIFESTYLE

The social culture and traditions of Georgians dwell on layers of historical experiences and a uniquely authentic civilisational core with occidental and oriental influences which came about through centuries of cultural exchange, travel, trade and war. Although, historically, Georgians are enthusiastic innovators and modernizers, at the same time they zealously preserve their unique culture.

The Georgian lifestyle may seem a little old-world-decadent. Georgians are hardly converts to the “great truths” of *economism* or believers in an *end of history* – their cultural world is too rich and their historical memory



as a survivor nation too long for this. Although as a rule creative and hard working, Georgians do not merely “live to

work”. In their rich social and cultural world, Georgians attach great importance to leisure, investing time in their social networks and families, dressing well and looking



good, tasty food, aesthetic perfection, romantic love, chivalric ideals in social relationships, sincere hospitality and generosity.

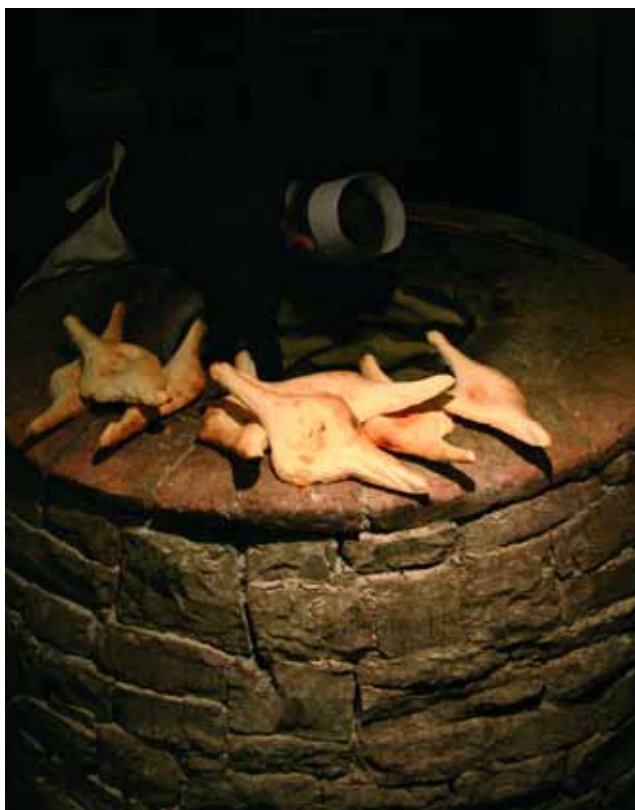
They appreciate more than the economic productivity-related aspects of life, and although passionate modernisers, often speak of spirituality and the continuity of their cultural history. For Georgians, "History" is not something currently irrelevant but a palpable reality of their continuing collective journey. Georgians revere their historical monuments, glorious kings and queens, national heroes and great artists. They consider themselves Europeans, although they have a deep understanding of the East.

Personal trust and reputation are indispensable factors in doing business with Georgians.

CUISINE

Georgian cuisine is one of the main attractions for foreigners visiting Georgia. It is famous for its uniqueness and diversity. An experienced traveller may discern some similarities between Georgian, and Middle Eastern and Mediterranean food. However, Georgian cuisine is doubtlessly an authentic gastronomic phenomenon. In fact, every historical province of the country has its own distinct cuisine perfected over centuries.

Georgian food includes all types of meat and fish. The choice of fruits, appetizers and vegetarian meals is even wider – as an ancient settled culture Georgians developed a



rich vegetarian menu. The different combinations of a variety of spices that are used in cooking in Georgia, fresh organic food, and the mastery of the cooks make Georgian food an unforgettable experience.

OVERVIEW OF ONGOING REFORMS

The first wave of reforms implemented in Georgia (1995-1997) during the post-Soviet period can be viewed as being only partially successful. Despite certain breakthroughs in many areas, initial success was reversed. In addition, the incomplete and inconsistent nature of the reforms in most cases created uncertainty and impediments in many sectors of public life. Due to ineffective management, the weakness of institutions, only partial transition to market mechanisms, and a high level of corruption, the unfinished and reversed reforms have failed to meet the high expectations of both Georgian society and the international community.

After the smooth, “velvet” transition of power in November 2003, Georgia’s current government has pursued a course of radical and irreversible reforms. The creation of a more favourable business environment is at the core of these policies. As President Mikhael Saakashvili declared at the Davos Economic Forum in January 2004, the priority of the government’s economic policy is openness to foreign direct investments, and the creation of a favourable environment for conducting business in Georgia. The irreversible reform of the Georgian economy is focused on minimizing state intervention and regulations, as well as creating firm institutional guarantees for the protection of investments and promoting international business cooperation in Georgia. This complex task requires a concerted effort, including harmonized initiatives in a wide spectrum of policy areas including public administration, legislation, taxation, customs, permits and licensing and judiciary, as well as in the rehabilitation of infrastructure.

ADMINISTRATIVE REFORM

One of the main priorities of the administrative reform is to downsize state administration and significantly reduce regulatory bureaucratic barriers. The major direction of this reform is deregulation, which implies a reduction in the number of controlling agencies and regulatory procedures which a businessman has to contend with when starting or operating his business.

The result of these reforms is the establishment of an efficient and flexible state administration, responsive to both public and business interests and able to function

effectively and with minimum expenditure. Redundant and ineffective layers of the state administration are being reformed/abolished; institutions responsible for economic policies, and law enforcement and judicial agencies are being optimized and the government institutions are becoming less intrusive and more efficient.

LEGISLATIVE REFORM

Despite the fact that by 1997 a quite liberal business-related legislative framework was in place, frequent and unsystematic amendments made to laws and other normative acts hampered the development of the Georgian economy. As a consequence, in this environment of constant uncertainty, it was exceedingly difficult for an entrepreneur to make any mid-term or long-term plans. Therefore,

despite attractive opportunities, many potential investors avoided the Georgian market.

The ongoing reforms have already established many important precedents and practices which increase transparency and facilitate the participation of stakeholders and interest groups in the process of drafting and amending legislation. Another important innovation is that the enforcement of any proposed change which may impact on the activities of any economic agent shall be delayed until the beginning of the following financial year. In this way the entrepreneur is granted more flexibility and time in order to adjust to

changes and thus minimize the risks and costs involved.

In parallel with institutional reforms, Georgian legislation is being harmonized with the legislation of the EU, WTO and other international institutions according to the international legal obligations undertaken by Georgia. As a result, a full-scale protection of investments, and also international trade, copyright and other related rights – protection of which was always a pending issue in the post-Soviet regions – will be fully guaranteed and enforced in Georgia.

TAX REFORM

It is the objective of Tax Reform to stimulate private business activity and encourage investments in the country.

Nowadays, conclusive steps are being taken towards significant liberalization of the tax legislation to meet the current needs of Georgia and to maximize the pace of its economic development. As the result, the new tax legisla-



Rose Revolution: citizens demanding reforms

tion – seemingly the most progressive and liberal tax code in the entire post-soviet area – will create a truly favourable business environment in Georgia.

More than 20 effective taxes will be reduced to only 8. Tax rates will also decrease. In addition, efforts are being made to simplify the system of tax administration in order to save the taxpayer's time and simplify procedures.

REFORM OF CUSTOMS SYSTEM

Given the favourable geographic location of Georgia, the reformation of customs administration is of primary importance. The reform envisages the creation of proper working conditions for importers and freight forwarders engaged in transit transportation. Pursuant to the agreements signed with the WTO and European Union, Georgia is currently engaged in bringing the customs legislation, procedures and rates into compliance with the norms of the WTO and the EU, thus creating unified and simplified procedures for importers and exporters as well as transit freight forwarders.

As an important precedent of liberalization in trade, particularly effective steps have been made towards the simplification of customs procedures with Turkey: one of our neighbouring countries and a major trade partner. The *Green Corridor* regime has been introduced at the customs checkpoints on the border with Turkey, encouraging a fast and efficient border crossing. A similar regime is scheduled to be introduced with all neighbouring countries in the course of time.

LIBERALIZATION OF THE SYSTEM OF PERMITS

Within many attractive segments of the Georgian economy for which business activities require special permits (for example, food industry, processing industry, and various services), a significant lack of investment can be observed. The requirement of these permits has often discouraged potential business partners and investors, and has also hampered the operations of existing enterprises. The system of licensing, permits and certification is being liberalized and simplified. It is now significantly easier to obtain the necessary permits: the timeframe for issuing licenses and permits is strictly limited and fees have been either abolished or significantly reduced. In addition, the list of businesses and goods subject to licensing and certification will be reviewed and greatly reduced.

The commitment of the government to bring the system of licensing and permits into full compliance with the standards of the EU undoubtedly constitutes major progressive change in this area.

JUDICIAL REFORM

The legal protection of private businesses and investments is of utmost importance. The role of the independent Judiciary in protecting property rights and investments, as well as in the resolution of disputes, is self-evident.

The judicial reform which commenced in Georgia a few years ago can be considered as one of the most successful reforms implemented in Eastern Europe and the post-Soviet area. Its major goal was to establish a politically independ-

ent, unbiased and impartial Judiciary system that would ensure the protection and security of private business in Georgia. This reform was successfully implemented and its positive results can be clearly observed.

REHABILITATION OF INFRASTRUCTURE

In common with many other post-soviet economies, Georgia has inherited an outdated, unprofitable infrastructure. Under-equipped, poorly managed, overstaffed state-owned enterprises that require high maintenance prices place a heavy burden on the shoulders of taxpayers. The reform policies in this area include a two-prong approach – the rehabilitation and optimization of management, and privatization.

Ports and railroads, a part of the communication infrastructure which represents a regional and international competitive advantage for the country, and other enterprises and facilities which, due to their unique characteristics, are of some special value, are subject to policies aimed at increasing their competitiveness and efficiency. This will be achieved through the optimization of management and technical modernization. In many cases privatization is the next step to rehabilitation. However, the majority of the state-owned facilities are being sold in their current condition. The approach adopted by the government is to set realistic auction prices based on the market value of these assets, so that the required investments in these facilities will prove economically feasible.

INTERNATIONAL SUPPORT

A strict commitment of the Georgian Government to cardinal reforms and their irreversibility has been strongly supported by international financial institutions and the international developmental community as well as by creditor governments. EU member states have already formally expressed their readiness to allocate to Georgia USD 1 billion. Since the beginning of 2004, Georgia along with 15 other states has been involved in the "Millennium Challenge Account" of the United States Government, aimed at assisting developing countries in overcoming poverty and executing legal and economic reforms. The World Bank and IMF have renewed and expanded their area-specific projects and programs, some of which had been suspended due to the failure of the previous government to pursue reform policies. Altogether, for a country of its size and population, Georgia enjoys perhaps the strongest possible international financial assistance to execute reforms and maximise its economic potential.

The high hopes and expectations of Georgian society for a better future, strong international support, and the current commitment of the Georgian Government to systemic reforms that will allow the current expectations of the broad public to be met: this is a rare combination of crucial factors that create the necessary prerequisite for the success of the reforms. These systemic reforms may in turn contribute to rendering Georgia a model case in post soviet space and in the Caucasus-Central Asia region as a whole.

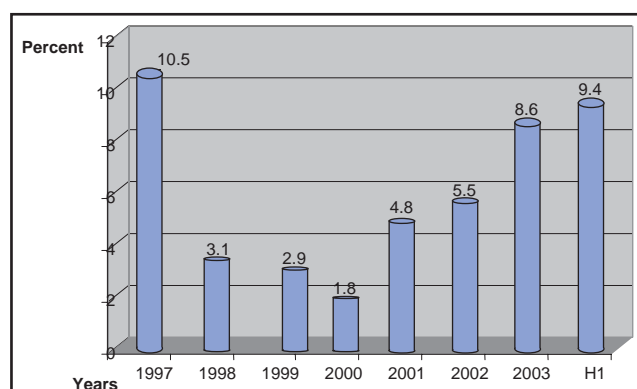
ECONOMIC TRENDS

ECONOMIC GROWTH

The systemic institutional reforms, the creation of a liberal legislative framework, and structural reforms in the economy which followed a period of economic collapse in the early 1990s has led to constant economic growth in Georgia since 1995. According to the preliminary estimates of the State Department of Statistics (SDS), Georgia's GDP in 2003 amounted to GEL 8,465.6 million (USD 3,948.1 million, i.e., USD 866.7 per capita). Currently, the Georgian economy is growing at a considerable rate. GDP growth rate increased by 3.2 % – from 5.4 % in 2002 to 8.6 % in 2003. Steady growth continued in 2004 – in H1 of 2004 it reached 9.6 %. A comparable rate of growth was only observed in 1997 before the impact of the financial crisis in Russia in 1998, after which a backslide in reform policies coupled with political corruption slowed down the pace of economic growth in Georgia from 1997 to 2001.

In 2003 and 2004 GDP growth was observed in every quarter compared with the corresponding quarter in the previous year. Chart 1 illustrates the tendency of the GDP growth from 1997 to 2003.

Chart 1: GDP Growth Rates (1997-2003)



Source: State Department for Statistics

SECTORS OF THE ECONOMY

The fastest growing sectors of Georgian economy were industry, agriculture, construction and service. The “Baku-Tbilisi-Ceyhan” pipeline construction project was a strong stimulus for expansion of the construction and service sectors. In addition, the project created a significant number of jobs, and consequently increased the income of the population, which resulted in an increase in domestic demand – a major driving force of economic growth in Georgia.

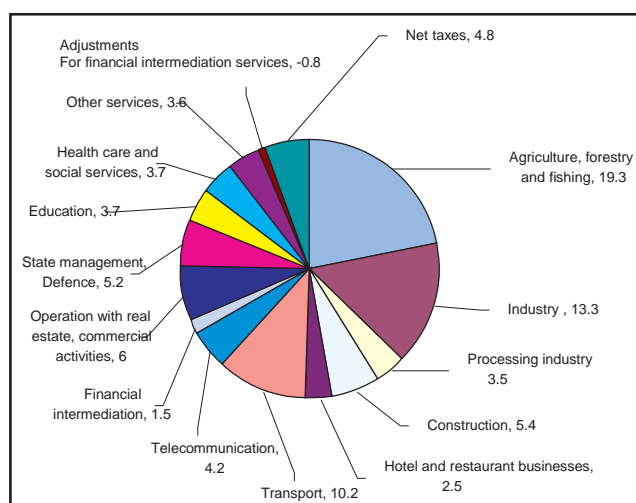
Table 1 shows the structure of GDP and the structure of its growth.

Table 1: Structure of GDP, 2002 - H1 2004
(GEL million)

	Share in GDP 2003 (per cent)	2003 vs. 2002 (2002=100)	H1 2004 vs. H1 2003	Share in GDP H1 2004 (per cent)
Agriculture, forestry and fishing	20.3	107.0	-11.1	19.3
Industry and construction	22.8	114.0	16.4	13.3
Industry	13.3	114.0	-3.3	3.5
Domestic processing of products	4.3	102.7	20.8	5.4
Construction	5.2	116.3	19.7	2.5
Services	51.5	111.0	1.9	10.2
Trade	13	107.0	37.7	4.2
Hotel and restaurant businesses	2.9	114.4	8.9	1.5
Transport	10.1	101.3	17.0	6.0
Telecommunication	3.5	131.3	5.1	5.2
Financial intermediation	1.5	119.8	1.6	3.7
Operation with real estate, commercial activities	5.9	118.0	8.2	3.7
State management, Defense	3.9	97.4	25.5	3.6
Education	3.2	101.7	-10.0	-0.8
Health care and social services	4.3	105.1	28.2	4.8
Other services	3.2	136.0	9.4	100.0
Adjustments by financial intermediation services	-1.1	124.6	H1 2004 vs. H1 2003 (a)	Share in GDP H1 2004 (per cent)
Net taxes	6.5	111	-11.1	19.3
GDP	100	108.6	16.4	13.3

Source: State Department for Statistics

Figure 2.1: Structure of GDP, H1 2004



Source: State Department for Statistics

As in many post-communist economies, non-recorded operations and the informal economy still remain among the major impediments to the economy. However, successful anti-corruption policies, together with increased institutional efficiency have resulted in a clear tendency towards the legalization of the informal economy.

Table 2: The Share of Non-recorded Economy in Total Output (Per cent)

years	2000	2001	2002	2003	H1 2004
Non-recorded	32.8	32.9	33.6	31.8	29.6
Recorded	67.2	67.1	66.4	68.2	70.4

Source: State Department for Statistics

TRENDS IN IMPORT AND EXPORT

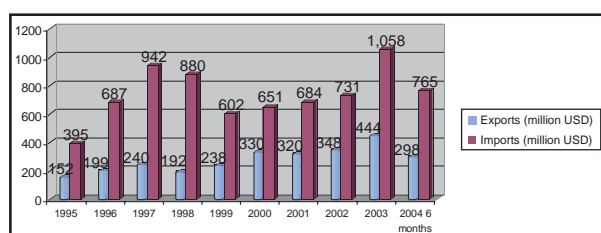
Georgian exports are partially concentrated on low value-added commodities such as ferrous metals, copper, aluminium, iron and steel and mineral fuels. However, in parallel with overall economic development, including the increase in industrial output, the share of low value-added commodities in exports is expected to decrease steadily.

Imports are dominated by mineral products, pharmaceuticals, food, and, due to the dependence of Georgia on foreign energy resources – fossil fuels and electricity.

The increase in imports in 2003 by a remarkable 45 % in USD terms can be attributed to the increase in the purchasing power of the population as well as to investment projects, especially the BTC pipeline construction.

Growth in both imports and exports continued at an even higher rate in 2004. In H1 2004, exports increased by 66 % compared with the same period in 2003, while imports increased by 57 %. In addition to the overall expansion of the economy, this trend can also be attributed to the anti-corruption policies of the government which brought about greater legalisation of import and export flows.

Chart 2: Trends in Export and Imports.



Source: State Department for Statistics

FOREIGN DIRECT INVESTMENT (FDI)

The improvement of the investment climate and the recent change in government as the result of 'Rose Revolution' has increased the flow of FDI to Georgia. Within the period between 1997 and 2003, FDI to Georgia amounted to USD 1,311 million. The highest levels of FDI (USD 334 million) were recorded during 2003 largely reflecting investments in the construction of the Baku-Supsa oil pipeline and the Supsa oil terminal. The FDI inflow to Georgia in 2003 was two times higher compared to 2002. The same positive trend continued in 2004 and FDI in Q1 2004 was two times higher than in Q1 2003.

Table 3 : Georgia - Foreign Direct Investments
(USD millions)

	1997	1998	1999	2000	2001	2002	2003
FDI	243	265	81	132	110	146	334
As percent of:							
GDP	6.8	7.3	2.9	4.3	3.4	4.4	8.5

Source: State Department for Statistics

A significant number of investors currently in Georgia arrived in 1996–97 – a period of great opportunity for niche businesses, including those that emerged in the context of Georgia's privatization program. According to many of these investors, political links (for example through diplo-

matic channels), also played an important role.

In comparative terms, Georgia's standing in attracting FDI ranks fairly high among developing countries of relatively similar size and natural resource endowment. Overall FDI flows into the CIS region have been rather modest – only 3% of total FDI flows to developing countries. In 2001, FDI flows to the CIS countries amounted to USD 7.2 billion, which were well below those to Latin America (USD 85 billion), Eastern Europe (USD 27 billion) and even Africa (USD 10 billion). Most FDI flow into the CIS countries has been linked to natural resource exploitation (e.g., oil and gas development) or/and privatization of state-owned enterprises, which is now winding down. In absolute terms, over 80% of FDI within the CIS region was directed to Kazakhstan and Russia. Among the CIS countries, and in per-capita terms, Georgia is faring better than most CIS countries, including such large economies as Russia and Ukraine. It ranks immediately after Kazakhstan and Azerbaijan (major Caspian oil producer countries).

MONETARY POLICY

The National Bank of Georgia (NBG) – the Central Bank – implements monetary policy in accordance with the annual programs – subject to approval by the Parliament. The major goals of the monetary policy are to keep the stable exchange rate of the national currency Lari (GEL) and to maintain the price level within the annual inflation of 5-6 %. Monetary policy is based on the strict control of money supply. The policy foresees that within a free float foreign exchange rate the NBG should not issue foreign currency in circulation even in the case of high demand. Meanwhile, the National bank of Georgia shall purchase foreign currency on Tbilisi Interbank Currency Exchange (TICEX) to maintain a sufficient level of international reserves. The NBG provides strict control over direct financing of the Government. However, during the last several years the NBG and the Ministry of Finance have been committed to the policy of total substitution of direct crediting by Government Treasury Bills.

The NBG employs the following market instruments for regulating money supply:

- interbank credit auctions;
- repo auctions;
- overnight deposits.

Reserve requirements for commercial bank deposits also play an important role in maintaining money supply: to increase the amount of the Lari in circulation, the NBG shall decrease the reserve requirements ratio and vice versa.

One of the main achievements of the Government in 2004 was a successful anti-corruption policy and the improvement of tax discipline, as the result of which tax revenues improved markedly. This stream of revenue has been accumulated in the Government accounts and correspondent accounts of commercial banks.

Interbank credit auctions were widely used to manage money supply (i.e. liquidity) by the NBG and commercial banks. The NBG issues money into circulation through extending credits. The money repaid by commercial banks is withdrawn from circulation. During January-September

2004 the turnover of credit auction exceeded the turnover of 2003 by 1.8 times. The NBG's share in total turnover achieved 74 %. Overnight deposits and repo were also used but their role in the maintenance of money supply was relatively modest.

During January-September 2004 the total supply of foreign currency on Tbilisi Interbank Currency Exchange (TICEX) was almost twice as high as in 2003. The nominal exchange rate of the Lari depreciated from USD/GEL 2.1 as of January 1st to 1.7 as of September 7th. Within these circumstances the NBG made a decision to start selling foreign currency on TICEX from September 15th in order to hamper the further appreciation of the Lari. After that measure the nominal exchange rate of the Lari depreciated gradually and has been fluctuating within USD/GEL 1.8300.

In conjunction with the improvement of tax administration, indirect taxes paid by importers should have been reflected in commodity prices. However, the Lari's appreciation offset the inflation and kept it within the 5-6 % annual targets.

ECONOMIC PROSPECTS

The prospects of economic development in Georgia are rather encouraging. Reforms implemented by the new government proved effective and viable and in less than one year resulted in drastic economic recovery. The package of reforms pursued by the government includes:

- strengthening the Rule of Law;
- decisive anti-corruption measures;
- liberalizing the tax code;
- privatizing state-owned property;
- improving infrastructure;
- investing in public education and human capital;
- A system of these interrelated and mutually supportive reform policies will further improve the investment climate in the country and attract FDI.

The realities of global political and economic development determine the international significance of the South Caucasus–Central Asia region and Georgia in particular. The increased interest of the world's major economic players in accessing the Eurasian markets, as well as diversification of the routes of transportation of Caspian oil and gas, assigns Georgia the role of a pivotal country – a gateway that connects Europe with Asia. In the short- and mid-term, successful reforms aimed at creating a favourable environment for international business, and the inflow of FDI, may transform Georgia into a regional hub of dynamic international business activity.

OVERVIEW OF GEORGIAN LEGISLATION

There has been a broad public and political consensus in Georgia regarding its integration into the international economy through the opening up of the Georgian economy for international businesses and the creation of a favourable investment environment. Based on this consensus, since 1995 the Parliament of Georgia has been working on the development of a package of liberal business legislation.

INVESTMENTS AND INVESTORS

By virtue of the Georgian Law on Facilitation and Guarantees of Investment Activities, any property, intellectual and material values or rights invested in the entrepreneurial activities on the territory of Georgia can be deemed as an investment. According to the law, the term *investor* applies to any individual or legal entity as well as an international organization. The law defines the concept of a *foreign investor* as follows: a foreign citizen; a person other than a permanent resident of Georgia; a non-resident Georgian citizen; a legal person (company) registered outside of Georgia (in other country).

REPATRIATION OF PROFITS

Article 3.1 of the law establishes that the rights of the foreign investor making investment and carrying out entrepreneurial activities in Georgia are protected and guaranteed equally to those of Georgian entrepreneurs. The foreign investor enjoys the right to repatriate profit or any other funds after payment of taxes and other mandatory

duties after conversion in the Georgian banking institution. It should be noted that the foreign investor also has the right to freely move any property owned by him out of the country. In accordance with international practice, the above-mentioned two rights can be restricted in exceptional cases on the basis of the law and court decision (bankruptcy, commitment of crime, and/or non-fulfilment of civil obligations). In other words, the law clearly specifies the circumstances in which these two rights (capital repatriation and right to move property out of the country) can be restricted, and eliminates the grounds for discretion by a public official. The existence of the specific law and effective court decision are required to restrict these rights.

PROTECTION OF INVESTMENTS

Special provision in article 7 of the law states that investment is wholly and unconditionally protected by effective Georgian legislation. The above article clearly defines the grounds and procedures for confiscation of investments. However, it should be noted that the provided mechanisms prohibit unconditional confiscation of investments and confiscation based on subjective discretion of government officials. Specifically, the following two rules are established:

Confiscation of investment (a) should be directly defined by the law (such a law does not exist). In addition, there exists another mandatory provision, (b) the relevant court decision on the investment confiscation. In other

words, two conditions should simultaneously exist to enable confiscation of investment (law and court decision).

Confiscation of investment in case of immediate necessity should be determined by the Organic Law (in Georgian legal framework, the Organic Law is superior to other laws and normative acts. Notably, the Rules of Procedure of the Parliament of Georgia require a larger quorum for adoption of an Organic Law compared to other laws. It should be noted that only the Constitution of Georgia and Constitutional Laws are hierarchically superior to the Organic Law). In addition to strict legal limitations that in fact make confiscation scarcely possible, confiscation of investment is allowed only with compensation. Compensation covers the market value of the investment as of the moment of confiscation and any loss incurred by an investor from confiscation till reimbursement of the compensation.



Parliament of Georgia

ILLEGAL ACTIVITIES CLAUSE

The law determines activities in which investments are not allowed internationally. This includes production of nuclear, bacteriological or other weapons of mass destruction; production and dissemination of illicit drugs; as well as other activities restricted or banned by international treaties and agreements.

DISPUTE RESOLUTION PROCEDURES

The Law provides investment-related dispute resolution procedures and lists the agencies concerned. The dispute between a foreign investor and a Georgian state agency can be resolved at the Georgian court or International Centre for Resolution of Investment Disputes. If a dispute is not submitted to the above agencies for review, then a foreign investor enjoys the right to apply to any arbitration agency set up pursuant to the procedures established by United Nations Commission on International Trade Law (UNCITRAL).

LEGAL REGISTRATION OF PRIVATE ENTERPRISES

The Georgian Law on Entrepreneurs introduces a simple and easily performed procedure for a company registration. The court has to issue a registration decision within five calendar days following submission of documents necessary to establish a company as determined by law.

LICENSING AND PERMITS

The Georgian Law on Principles for Issuing Licenses and Permits defines the complete list of activities subject to licensing and permits to be granted by authorized state, administrative or local bodies. According to the law, a *license* is a right granted by the administrative body to perform the relevant activity for undefined term and under requirements specified by the law. A *permit* is either a one-time right or right issued for a restricted period of time to perform relevant entrepreneurial activity on the certain territory under requirements specified by law. The law provides a unified list of activities subject to mandatory licensing and permits. The law requires payment of a fee necessary to obtain a license or permit. The amount of the fee depends on the type of activity. By virtue of

the law and article 100 of the General Administrative Code of Georgia, the administrative body is required to issue an administrative act on granting a license or permit within one month after an application is filed. In some areas of business activity, the mandatory timeframe for issuing licenses and permits is even shorter.

CONCESSIONS

Pursuant to the Georgian Law on Concessions Granted to Foreign Countries and Companies, a Concession Agreement can be concluded on the processing of recoverable and non-recoverable natural resources and the performance of related works and activities. By its essence, this agreement falls under the category of lease-concession agreements. The foreign investors conclude a concession agreement with the relevant state body authorized by the Georgian legislation (for example, Ministry of Environment and Natural Resources of Georgia). Pursuant to the law, a concessionaire (a foreign investor) has the same right to repatriate profits as any other foreign investor. In addition, the investor enjoys the right to appeal unlawful acts or decisions made by the state body at court or arbitration.

EXPROPRIATION OF INVESTMENTS

The Georgian Law on Procedures of Confiscation (Seizure) of Property for Eminent Domain states that investments are expropriated (i) on the basis of the Presidential Decree, and (ii) under the relevant court decision in favour of the state body or any other person granted the expropriation right. It is noteworthy to mention that both the Presidential Decree and court decision can be

issued only in case where there exists substantiated evidence of "sine qua non public necessity"; the expropriation issue can not be decided in case of absence of such a condition. It should be again indicated that a mandatory compensation is paid in case of expropriation.

The Georgian Law on Procedures of Confiscation (Seizure) of Property for Eminent Domain provides procedures for confiscation of property. This organic law clearly defines that property may be confiscated in case of environmental and natural disasters, epidemics and epizooties endangering the health and life of a person(s), or state and public security. The decision to confiscate property is made by the President of Georgia as well as the central, autonomous or local body on the operating territory on which the property is located. It is important to note that property is to be evaluated at the market price and the sum to the amount of the assessed property value is to be transferred before the actual confiscation. The owner has the guaranteed right to file an appeal (on confiscation of property and reparation of damages) at court in the event of termination of conditions that caused confiscation of property (environmental and natural disasters, epidemics and epizooties).

PROTECTION OF PRIVATE AND CORPORATE PROPERTY

By virtue of the Georgian Constitution and the Georgian Civil Code, the right to property is guaranteed and protected both by legislative and administrative/judicial mechanisms. Importantly, article 6.2 of the Constitution reads that international treaties or agreements made between Georgia and other parties (states or companies), unless contradictory to the Georgian Constitution or Constitutional Law, are superior to internal normative acts.

In Georgia, the property, investments and rights of investors are protected and guaranteed. The law defines simple and easily understandable schemes to make investments, to purchase (transfer) property or set up a company. The legislation provides clearly and strictly defined mechanisms for the protection of property and investments, which, on the whole, ensures a liberal legislative environment for conducting business and making investments in Georgia.

PRIVATIZATION

Since the start of the privatization process in Georgia in 1992, more than 15,000 enterprises have been privatized. The number of the remaining state-owned enterprises is quite substantial - there are approximately 1,800 small, medium and large enterprises with state participation, employing over 180,000 people. For the new government of Georgia privatization is a crucial component of the ongoing systemic reforms. Major trends in the current privatization policy include the quick transfer of the remaining enterprises into private ownership and a radical deregulation of the economy in order to mobilise private investments. The new Government is firmly committed to attracting foreign investors and creating a more favourable environment for business in the country. The opening up of the Autonomous Republic of Adjara, where very little privatization has taken place in past years, will have a positive effect on the overall process.

In 2005 Georgia will become a more attractive country for both domestic and international investors due to the parameters of the new Tax Code. In the summer of 2004, the Ministry of Economic Development has published a list of 372 enterprises where the state is offering its share for sale by auction. This wave of privatization should be completed

within the period of two years. To ensure the impartiality and transparency of the privatization process and worldwide access to information, the Ministry of Economic Development distributes information about privatization through its official publication and other newspapers and also through its web site (www.privatization.ge).

Improvement of government institutions, and to ensure the efficiency and transparency of key state-owned enterprises (SOEs) are among the top priorities of the 2004 reform agenda. In the past, the government was unable to provide effective management of these state-owned enterprises and their financial reports were neither reliable nor systematic. As a result, many large SOEs were not subject to rigorous budget constraints, and systematically evaded the payment of a substantial proportion of

taxes and dividends to the budget.

In 2003, the Ministry of State Property Management was dissolved, and its tasks were transferred to the Ministry of Economic Development (MED), which has assumed responsibility for privatization. A the Enterprise Management Agency (EMA), which is a part of (MED), now oversees the management of SOEs by appointing supervisory boards and



preparing enterprises for privatization. In order to ensure transparency, procedural openness and fair competition in bidding, the EMA has set up new procedures for subsequent privatizations (including medium- and large-scale SOEs). This improved transparency and accountability of SOEs is viewed as an effective tool for better performance. The accounts of three major companies (Georgian Railways, Poti Port, and Madneuli Mining Company) are being audited by reputable international experts, selected in July 2003. Based on the experience gained in 2003, the government is planning to broaden the coverage of international audits to SOEs with a turnover exceeding GEL 10 million, commencing, in 2004, with the state telecommunications company (Elektrokavshiri) and the Tbilisi Airport Authority.

MEDIUM AND LARGE ENTERPRISE PRIVATIZATION

The government is taking decisive steps in order to proceed with the privatization of those medium and large enterprises (MLE) which are still in state ownership. Past experience has revealed the inefficiency of the procedures which were implemented for the privatization of large Georgian enterprises (tender commissions failed to assess the actual implementation of investments). The enterprises are oversized and the assets are in poor condition; indebtedness, overstaffing, and the influence of those with a vested interest have also aggravated the situation.

The government is taking adequate steps and policy measures in the privatization of the MLEs. In such sectors as energy, telecommunications, manufacturing and transport many assets have become a heavy burden for the economy and urgently need either restructuring, rehabilitation, or liquidation as necessary steps for subsequent successful privatization. This process is currently under way.

In 2004 the Government developed a policy of privatizing the vast majority of state-owned enterprises. As it was mentioned above, the Ministry of Economic Development has published a list of 372 enterprises for which the state is offering its share for sale by auction. The list includes the largest enterprises such as JSC "Tbilaviamsheni" (Aircraft Construction Plant), Rustavi Metallurgic Plant, Tchiatura Manganese Plant, major telecommunication companies ("Sakartvelos Elektrokavshiri", "Sakartvelos Telekom", "Sakalaktashoriso Kavshiri"), Tbilisi, Batumi and Poti Airports, 5 hydro power stations in Imereti region, and also a number of oil terminals and gas distribution companies.

In many enterprises, an ongoing evaluation and auditing process is to be completed. The government is taking policy steps to establish clearly the authorities responsible for each and every asset to be privatized. The identification of those bodies responsible for each of the enterprises will exclude any possible future claims of different parties, which would hamper the smooth and proper privatization process.

Opening up the Autonomous Republic of Adjara for privatization, which is part of Georgia's Black Sea Riviera and accommodated hundreds of thousands tourists in 1980s, prompted the introduction into the privatization list of 26 enterprises from the tourism sector. To date the Ministry sold by tender "Intourist" LLC, whose core activity is centered on the hotel business in Batumi. The State's share in the authorized capital is 100 %. The enterprise was sold by auc-

tion for USD 3,020 thousand. Initial minimum purchase price was USD 3 million.

The Government is planning to take steps to restructure the enterprises and implement liquidation/bankruptcy procedures to make these enterprises attractive for foreign investors. Bankruptcy procedures lead to the reorganisation/rehabilitation or liquidation of insolvent enterprises. Liquidation/bankruptcy procedures have been initiated in some MLEs; in others rehabilitation programs are under way. If rehabilitation is successfully implemented, the enterprises will be able to service their debts, improve overall performance and become efficient, which will facilitate the privatization process and will result in larger revenues to the state.

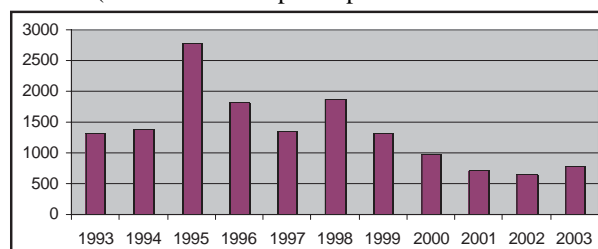
The Ministry of Energy is preparing for the privatization of 5 electricity generator companies in Imereti region, 29 gas distribution companies and several additional assets, all of which are included in the privatization list. Although the actual privatization is scheduled for 2005, preparatory work has already begun, including the grouping of the assets into lots in order to make them more attractive to investors. For example, the 5 electricity generator companies in Western Georgia will be reorganised into a single Legal entity.

SMALL ENTERPRISE PRIVATIZATION

The privatization of small enterprises in Georgia began in 1993. Figure 1 below illustrates the dynamics of the small enterprise privatization by year. The largest numbers of enterprises were privatized in 1995, when the Georgian economy started to stabilise and in 1998, when the largest zero reserve price auctions were held. Since that time it has become apparent that privatization is approaching its conclusive stage, as the amount of available entities is diminishing (see Figure 1). The privatization of large enterprises is still underway (telecommunications, energy, manufacturing sectors) and presumably there will be new small enterprises created as a result of that restructuring. Thus the privatization process of small enterprises still offers interesting opportunities.

Figure 1: Small Privatization

(Number of enterprises privatized in 1993-2003)



Source: Ministry of Economic Development

By March 2004, 14,117 small enterprises had been included in the privatization list of the Ministry of Economic Development and 17,680 small enterprises had been privatized since 1993. In 2004, 109 small enterprises were privatized. The discrepancy between the total number of small enterprises actually privatized and those approved for privatization indicates that many of them were split during the privatization process. The increasing number of the small enterprises approved for privatization suggests that many of them had been parts of MLEs and became independent units after the restructuring of the latter.

The majority of small enterprises operate in trade and service sectors - 32 and 46 % respectively. The bulk of the privatized small enterprises are located in Tbilisi. Although in 2003, certain number of enterprises were privatized in all regions of Georgia. For political reasons, in the Autonomous Republic of Adjara the privatization process had been stalled for years. Thus recent developments seem to have had a positive effect on the opening up of the region for privatization which is currently entering its initial stage. Local entrepreneurs have already expressed an interest in privatising small enterprises. Increased competition in Adjara will become a driving force for the future development of this region.

The government is strictly committed to the deregulation of the economy and the privatization of major state owned enterprises. The reformation of public administration, strengthening transparency and accountability has created optimal preconditions for competitive market-based privatization. Improved legislation covering procedures for state property privatization, as well as improved management standards of state owned enterprises, secure the interests of both

the State and potential investors. The fact that this process has started recently creates attractive opportunities for businesses interested in investing in the Georgian economy.



State Concert Hall

TAXATION

In order to create an attractive investment environment, the Georgian Government is taking serious measures to simplify and liberalize the Tax Code. That the Draft Tax Code prepared by the Government received a first reading approval in the Parliament demonstrates that the main direction of the tax policy is the optimal taxation of entrepreneurs and the promotion of their economic activity.

The Government is planning to simplify the Tax Code by reducing the number of taxes and abolishing inefficient tax concessions. It must be noted that the Draft reduces the 21 current taxes payable to the central and local budgets to only 8 taxes, which is unprecedented in the country's history. Abolishing the inefficient tax exemptions and concessions will reinforce fair competition in the business. In addition, the Government is planning to harmonize the Georgian legislation, including the tax legislation, with that of the European Union: this policy was reflected in the Draft Tax Code.

The cornerstone of the tax reform is the reduction of income tax rates from 20% to 12%, and the reduction of the social insurance tax from 31% to 20%, thus promoting economic activity not only of physical persons (employees as well as sole proprietors) but also of legal entities (employers). By taking these measures the Government refuses to increase the Budget revenues through preserving or increasing the current income tax and social tax rates, but rather targets revenue legalization and taxable base growth through supporting the expansion of economic activity of legal entities and physical persons.

It must also be noted that the income and social tax rates are low in Georgia as compared to the other countries of the region, thus helping to create an attractive environment for investment. E.g.: the income tax rate in Azerbaijan is 12-35%, in Armenia – 10-20%, in Russia – 13%.

Through preserving the 20% tax rate, the Draft provides

for substantial changes in the Profit Tax (corporate income tax) calculation scheme, intended to stimulate investment and reinvestment processes. Specifically, the distributed dividends of an enterprise established by a resident in compliance with the Georgian legislation shall be exempt from taxes at the source of payment and profit tax shall not be included in the gross income. In addition, in parallel with accelerated amortization, enterprises can fully exclude the costs of purchasing or producing fixed assets used for their economic activity from the gross income: i.e. the 100% in amortisation can be applied immediately upon the start-up of the fixed assets. This will considerably promote the fixed asset renovation process.

The taxation rules for foreign enterprises involved in the international transportation of passengers and cargo has also been changed. Thus the taxable profit of such enterprises shall be calculated in accordance with the internationally recognized so called "Marine Formula", which considerably reduces the possibility of any unjustified increase of taxable profit.

According to the Draft, taxable gross income and its deductions will be determined as follows:

- The excess deductions from revenues (loss) can be forwarded for a five year period;
- The profit of a legal entity is exempt from taxes if the value of initially supplied agricultural products (prior to processing) does not exceed 100,000 GEL during one calendar year;
- Tax exemption is extended to the amounts transferred to charity organizations, equalling 8% from taxable income.

The Georgian tax system becomes more attractive since the Draft fully reflects the provisions of the relevant EU legislation with regards to VAT. By means of improving the

tax administration process, the Government intends to:

- reduce the VAT rate from 20% to 18% - the lowest rate in the CIS countries;
- introduce an upper limit of taxable turnover required for mandatory registration of a VAT payer of 100,000 GEL;
- abolish the minimum level of taxable turnover required for voluntary registration.

In order to encourage fair competition, the list of commodities and services exempt from VAT is reduced significantly. VAT credit paid (payable) to suppliers while purchasing goods and services will be carried out based on tax invoices, in compliance with the tax returns submitted for the relevant reporting period. VAT refunds are introduced. Besides the standard VAT rate, the Draft envisages zero VAT rating for the export of commodities. Zero rating will also be extended to:

- transportation and other services immediately relating to the international transportation of cargo and passengers;
- tourist services provided by tour operators for foreign tourists on the territory of Georgia;
- the rehabilitation of fixed assets on the Georgian territory, conducted by foreign enterprises.

Excise-duties are applied to:

- alcoholic beverages (0.1-2.50 GEL per 1 litre);
- oil products (150-250 GEL per 1 ton);
- tobacco products (0.20-0.80 GEL per 20 items)
- cars (7%).

In addition, excise tax will be payable for the import of excise goods and domestic production of excise goods by

manufacturers, while the export of excise goods is taxed at zero rate. Similarly to the effective legislation, the Draft provides for the credit of excise paid for production inputs used for manufacturing goods.

The arrangements of tax payment for using natural resources remained the same. At the same time the quantity (volume) of extracted natural resources is taxed. That is, the tax is determined for nonferrous metals, precious and rare metals, precious gems, thermal ground water and potable water, oil and gas, mineral water, timber resources of the forest fund and other natural resources.

In order to simplify the system of taxes, the Draft provides for a combined property tax in which the property and land tax of legal entities and physical persons are integrated. Property tax rates are left unchanged, equalling 1% of the residual balance value, while in the case of physical persons it is planned to increase tax rates (for immovable property) in order to cover the cost of tax collection and improve tax administration.

The process of drafting the new Tax Code includes a series of public hearings and consultations between the government and various stakeholders:

- representatives of the business community,
- The Taxpayers' Union of Georgia (the major national business association and lobbying group);
- international financial organizations;
- interest groups and NGOs.

Consultations seemed to be effective and the government willing to negotiate. As a result, a number of changes aimed at further liberalization of the business environment have been made.

INDUSTRY

GENERAL DESCRIPTION OF INDUSTRY IN GEORGIA

At the time of the dissolution of the USSR in 1991, Georgia inherited a rather diversified sector of industry – a wide range of industrial enterprises, from food and timber processing, production of fertilizers, and coal and magnesium ore mining, to steel and non-ferrous metallurgy, and locomotive, fast boat and aircraft assembly plants. Many of these industries have been and still remain unique natural monopolies in the broader region. However, ineffective managerial practices and high costs of infrastructure maintenance were a part of this legacy. In addition, the dissolution of the USSR was accompanied by the fracturing of supply lines and the elimination of the soviet-time guaranteed state contracts. As the

result, as in many former soviet countries, Georgian industry declined dramatically. Industrial decline reached a critical point in the first years of independence (early 1990s) – a period of political instability when production dropped to unprecedented levels.



Rustavi Steel Factory

Recovery and growth in industry followed from political and economic stabilization, legislative reforms, essential steps towards market economy (especially privatization and liberalization of trade), the development of the private business, and foreign direct investments. A great number of industrial enterprises were privatized or transformed to joint-stock companies. The restructuring of oversized Soviet-style mega-enterprises

facilitated the creation of economically efficient, competitive industries as well as the development of small- and medium-

size businesses in the sector.

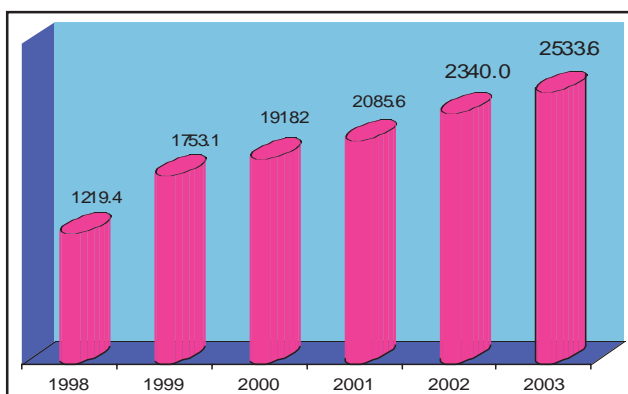
Many industries were revived and modernized, and a modern managerial culture introduced. Many Georgian industrialists, especially new-generation entrepreneurs, managed to deal successfully with the challenge of upgrading to a new international standard of production for a demanding international market.

Foreign economic policy has had a positive influence on the growth in the industrial sector. The government has actively sought integration into international markets, and the country is a member of the World Trade Organization. Given the limited local market, this should considerably facilitate investment in the export producing sectors. In addition to the implementation of its obligations as a WTO member, Georgia has signed agreements on mutual support and protection of investment with more than 23 countries, and agreements on the elimination of double taxation with 11 countries.

TRENDS IN GROWTH OF INDUSTRIAL OUTPUT AND ITS SHARE IN GDP

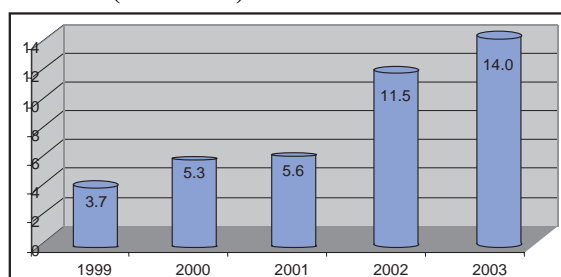
As a result of change in the macroeconomic and business environment, as well as the restructuring of the sector itself, the major trend in restructuring the sector in recent years was a significant increase in the number of new industrial private enterprises in the total industrial output. Between 1990 and 2003 the number of industrial enterprises more than doubled, their number increasing from 1,365 in 1990 to 3181 in 2003. Since 1998, the volume of industrial output has been growing at an average annual rate of 8 % (see Charts 1 and 2).

Chart 1: Increase in Industrial Output in Actual Prices in mln. GEL (1998-2003)



Source: State Department for Statistics

Chart 2: Rate of Growth of Industry (1999-2003)

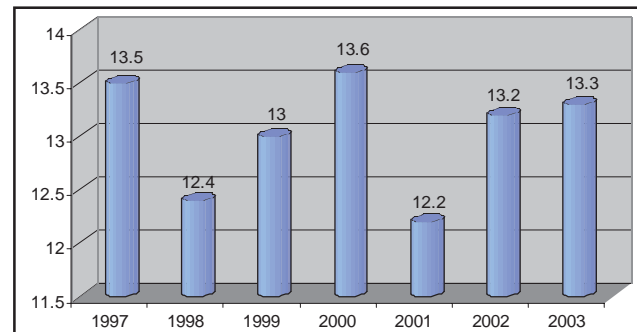


Source: State Department for Statistics

Outstanding growth of the sectoral output was observed in 2004, and the registered output of industrial enterprises in H1 2004 increased by 16.5 % compared with the corresponding period in the previous year.

The share of the sector in GDP remains more or less constant, in the range of 12-14 %.

Chart 3: Share of the Industrial Output in GDP



Source: State Department for Statistics

SECTORS OF INDUSTRY

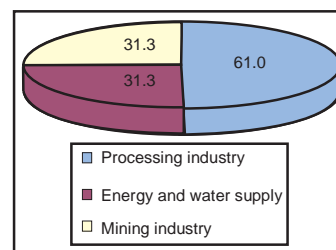
The composition of shares of the main industrial sectors in the total industrial output was the following:

- Processing industry 61.5 %;
- Energy and water supply 30.1 %;
- Mining industry 8.4 %.

In H1 2004, the shares of these sectors changed slightly:

- Processing industry 61.0 %;
- Energy and water supply 31.3 %;
- Mining industry 31.3 %.

Chart 4: Distribution of Industrial Output by Sector



Source: State Department for Statistics



Madneuli Deposit

Table 1: The Data on Enterprises by Sector

	Number of enterprises
Mining	92
Coal and lignite extraction, peat processing	5
Extraction of crude oil and gas	2
Extraction of metallic ore	22
Other	63
Processing	2920
Processing of food products and production of alcoholic drinks	1685
Tobacco production	13
Textile products	17
Garment industry, fur processing	39
Leather processing and footwear production	43
Timber processing excluding furniture production	265
Pulp and paper	26
Publishing industry	230
Production of coke, oil distilling products and nuclear fuel	8
Production of chemicals	72
Production of rubber and plastic products	49
Production of non-metal and other mineral resources	172
Main metal production	20
Production of finished metal products except machinery and tools	68
Production of machinery and equipment	41
Stationary and calculating machines production	1
Electric machinery and other equipment production	31
Radio, TV and communication equipment production	6
Medical and optic equipment and clock production	14
Production of vehicles and trailers	14
Other transport equipment production	22
Production of furniture and other finished goods	81
Recycling production	3
Electricity, gas and water supply	198
Electricity, gas, steam and hot water supply	95
Water reserving, distilling and distribution	74

Source: State Department for Statistics

SHARES OF LARGE, SMALL AND MEDIUM ENTERPRISES IN THE SECTOR

Despite the strong upward trend in the establishment and development of small- and medium-size industrial enterprises, still a relatively small number of enterprises produce the bulk of country's industrial output – 50 enterprises account for more than three quarters of industrial products. Interestingly, only 16.7 % of aggregate industrial output was produced by small and medium size industrial enterprises. In comparison, in highly developed industrial countries, the share of small enterprises in national industrial output is as high as 50-60 %. In this regard, the elaboration of the new draft of the Tax Code, which is more liberal and favours small- and medium-size enterprises, can be considered as a very positive institutional change conducive to the development of the industry.

THE IMPACT OF REFORMS

It can be inferred that the share of the small- and medium-size industrial enterprises in total output will steadily increase. Before the change of government as the result of the "Rose Revolution", the development of small- and medium-size enterprises was hindered by faulty legislation and widespread corruption. In previous years, the practice of "state capture" and unfair competition was still in place. In such a political-economic environment, the success of the most economically viable enterprises strongly depended on lobbying by means of bordering with illegal, and small and medium enterprises had little chance for survival and further development.

The new government has removed these impediments over a short period of time and, through a series of reforms, contributed to the formation of an essentially new, favourable business environment which benefits small and large enterprises alike. The new, liberal tax code is to be adopted in the near future. Importantly, the code favours small- and medium-size enterprises and can be considered a breakthrough in stimulating the development of the industrial sector. Reforms were no less beneficial for large-scale producers. The transparency of the current policy-making process, the participation of the stakeholders in creating a new liberal business environment (e.g. a series of consultations between the government and industrial entrepreneurs in the process of drafting the new tax code), and the establishment of new rules that put lobbying by interest groups into the frames of legality, together created the necessary preconditions for fair competition and minimized non-economic factors of risk and unpredictability.

The industry sector in Georgia includes various opportunities for a potential investor. The sector is evidently growing. Infrastructure for wide variety of fields of industry, as well as skilled labour, including professional engineers, is in place. Many enterprises are unique in the region. Despite the trends of growth, the potential of industrial enterprises is far from being fully utilized. Both domestic and potential export market conditions are favourable. The policy of liberal privatization will attract foreign direct investments, which will allow for the technological modernization necessary for products to be competitive. As a consequence, the expected development of the sector, in combination with the advantageous location of the country and the structure demand in the regional market, may turn Georgia into an ideal production and export platform within the region.

BANKING

GENERAL OVERVIEW

In recent years, substantial progress has been achieved in the banking sector Georgia. The reform in the banking system has been implemented by the National Bank of Georgia (NBG) and is based on the IMF recommendations. As the result of the reforms the number of banks decreased



from 228 at the end of 1994 to 21 at the end of June 2004, mostly at the expense of insolvent banks and those that could not meet the NBG's special requirements. 13 of the existing banks have foreign shareholders including EBRD, IFC, German Investment and Development Foundation and other international financial organisations. There are two foreign banks: Azeri and Turkish; however, neither of the two provides lending or depositing services in Georgia.

The process of bank enlargement has steadily continued since 1994. At the beginning of 2003, 80% of banks' assets and 85-90% of banks' deposits were accumulated in 8 commercial banks. Currently, there are 6 commercial banks which hold an 81 % share of the aggregate assets, 86 % of the liabilities and 85 % of deposits. These 6 banks have expanded their branch networks and diversified their services. They introduced customer services based on modern banking technologies and provide internal settlement in real time.

In 2003, the following grades were awarded to Georgian banks according to the Capital, Assets, Management, Equity and Liquidity (CAMEL) system.

- Grade 1 – one bank
- Grade 2 – seven banks
- Grade 3 – four banks
- Grade 4 – two banks
- Grade 5 – one bank.

Only one out of the top 6 Georgian banks was rated by the international Fitch rating agency. In 2003 the bank was rated CCC+.

As of April 1st 2004, loans comprised 54 % of the banks' assets. Deposits represented the largest share of banks' liabilities (75-80 %). There is a high level of commercial banks' dollarisation of both assets (83 %) and liabilities (66 %).

LEGISLATIVE FRAMEWORK

Economic reforms initiated in 1995 and the macro-economic growth has considerably promoted the establishment of favourable conditions for the further development of banking in Georgia. At the same time, current banking legislation was created. The new Law concerning the National Bank of Georgia was adopted in 1994. The law upgraded the supervisory authority of the National Bank over the activities of commercial banks. This included:

- the right of adoption of respective regulatory rules;
- the licensing of commercial banks;
- the introduction of prudential standards;
- the inspection, imposition of sanctions.

The new Law on the Activities of Commercial Banks, introduced in 1996, set forth major conditions for the taking up and pursuit of business by commercial banks. Changes and amendments to these Laws made in 2001-2002 can be considered as a sizable step forward in terms of banking regulation. These substantial changes:



- reinforced and improved the supervisory and regulatory functions of the National Bank;

- set forth proper criteria for bank administrators and qualifying shareholders,
- introduced limitations with regard to the acquisition and disposal of the qualifying share of a bank,

In order to secure the financial stability of commercial banks and protect the interests of their creditors and depositors, the National Bank of Georgia, supported by international financial organisations, elaborated and enforced so-called 'prudential regulations'. In 1997 the National Bank of Georgia introduced the rating system for the evaluation of the financial standing of banks – CAMEL (Capital, Assets, Management, Equity and Liquidity).

Among the sub-legal normative acts adopted by the National Bank of Georgia are:

- the rules of licensing of commercial banks;
- rules of supervision and regulation of activities of commercial banks;
- a new system of classification of assets and setting up the possible loss provisions;
- fit and proper criteria for the bank administrators.

The International Accounting Standards have been applied to commercial banks accounting system have been applied since 1 January 2001. The banks were required to reorganize into Joint Stock Companies as of December 31, 2002.

For the time being the bank reform implemented by the National Bank, with due consideration to the recommendations made by the International Monetary Fund, is considered to be one of the most successful sectoral economic reforms in Georgia. This reform has considerably promoted the reinforcement of the banking system and also the commencement of the process of winding up the weak banks.

The alignment of Georgian standards for the licensing and regulation of activities of commercial banks facilitates the improvement of the banking service in the country, and the further strengthening, stability and effective functioning of this sector and the protection of the interests of the depositors. This in turn provides for the growth of confidence in the banks.

In the process of harmonisation of the Georgian banking legislation with that of the EU, and further development of the commercial banking system, the NBG increased the minimum paid-in capital up to GEL 12 million (The EU standard for paid-in capital for banks is EUR 5 million). According to the NBG's Order of January 13, 2004, all newly established banks, including branches of foreign banks, are required to possess paid-in capital of GEL 12 million. For already established banks this requirement should be fulfilled by December 31, 2008 according to a special schedule. As a result of this policy, weaker banks will be liquidated or merged and others will attract new shareholders.

The banking sector in Georgia is likely to expand in the short- and mid-term future. If a favourable investment climate is in place, there is a great probability that there will be a significant inflow of foreign capital into the Georgian economy. The increase of authorized capital requirement has another advantage. The process of enlargement of banks stimulates the inflow of money from the informal sector into the banking sector. The growth of the investment

possibility of banks will increase their role as mediators in the financial market. At the same time, strengthened banks would provide better and more extended services to customers. The trust of the Georgian population in the banking system would also increase as a consequence.

In 2002-2003, significant steps were made to develop fit and proper criteria for top managers and shareholders in commercial banks, in accordance with the harmonisation of Georgian banking legislation with that of the EU.

As a Member of the Council of Europe, Georgia enforced legislative measures against money laundering that also required the improvement of commercial banks' standards.

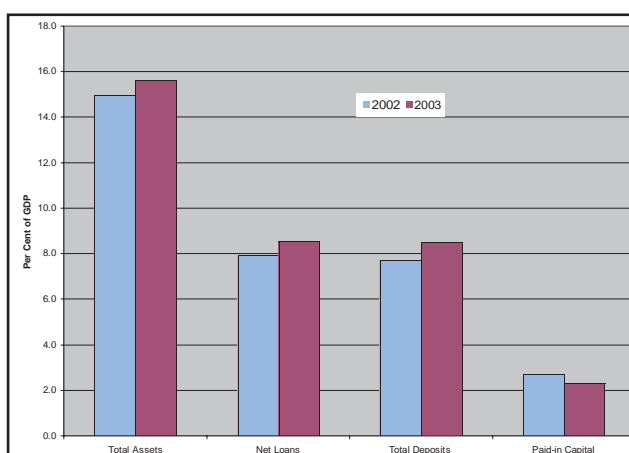
RECENT DEVELOPMENTS

The main direction of current reforms in the banking sector is to create stable and capitalized banks with a wide range of services, diversified investment portfolio, adequate risk management and high confidence among institutional investors and the population.

Substantial progress has been achieved in the diversification of banks' activity. The problem was very topical even 3 years ago due to the fact that Georgian banks had the biggest share of income from loans, which made them open to injury from bad loans. In 2001, 92 % of interest income of commercial banks was from extended loans. By the end of H1 2004, this indicator fell to 52 %, while the share of non-interest income became 41 %. These figures indicate that banks had developed other services, which made them less vulnerable.

As the result of successful reforms in the banking sector the role of the banks in the economy has been increasing gradually. The figure below shows shares of total assets, net loans, total deposits and paid-in capital of commercial banks in GDP in 2002 and 2003. The share of paid-in capital in GDP remained low, which indicates undercapitalisation of the banking system.

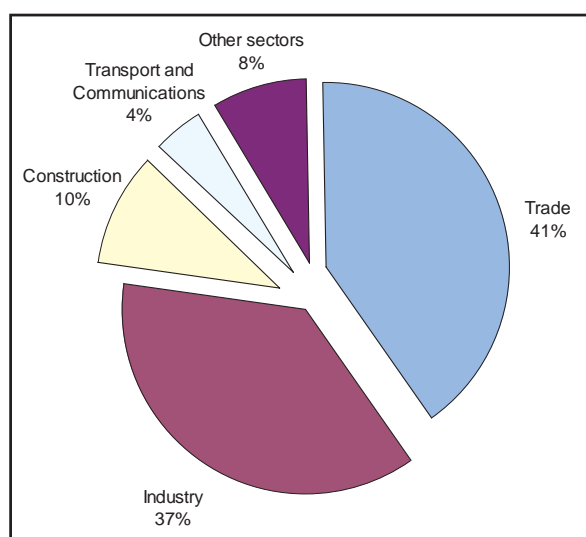
Chart 1: Share of Total Assets, Net Loans, Total Deposits and Paid-in Capital of Commercial Banks to GDP (2002-2003)



Source: Calculations based on data provided by the National Bank of Georgia

Even a few years ago, the largest share of loans from the commercial banks' were extended to finance operations in trade, while the opportunities for industry and agriculture sectors' to obtain bank loans remained limited. According to the National Bank's data, in March 2001, 70 % of total loans were allocated to trade, while by March 2002 that indicator achieved 77 %. As the result of the positive trends in the economy, and successful reforms in the banking sector in 2003 and 2004, the share of industry in the loans portfolio increased notably. The figure below indicates the distribution of loans within the sectors of the economy as of June 2004.

Chart 2.: Distribution of Loans Issued by Commercial Banks (as of June 2004)



Source: Calculations based on data provided by the National Bank of Georgia

One of the most important steps to increase the role of banks' in lending to industry and agriculture is to take necessary policy measures to stimulate the movement of cash from the non-registered sector into the banking sector. Positive results are likely to be achieved because the strong anti-corruption measures implemented by the new Government lead toward the reduction of the shadow economy and cash inflow into the banking system.

Between the end of 2002 and the June 30th 2004, the

share of long-term loans (excluding overdue) increased from 38 % to 54 %.

The poor role of the Lari as the means of saving and capitalisation is reflected in the structure of deposits in commercial banks, where deposits denominated in foreign currencies dominate those made in the national currency. The share of foreign currency deposits in total volume was 96 % as of July 1st 2004. The largest share in foreign currency deposits comes from household deposits, which indicates that the Lari still plays an insignificant role in savings. The average spread between interest rates of loans and deposits is 18 % in the national currency and 10 % in foreign currencies. On average, even after the nominal appreciation of the Lari, commercial banks pay more interest for long-term Lari deposits than for US dollar ones, which reflects the banks' expectation of some depreciation of the Lari in the long-term. Also loans in the national currency have become more expensive, especially in 2004. This can be explained by the nominal appreciation of the Lari, as banks had to avoid income loss in dollar terms. However, the share of loans in the national currency is relatively small (12 %) in the total loan portfolio of commercial banks.

Further improvement in the banking sector in Georgia should be achieved as the result of:

- increasing capitalisation;
- improving management of lending and deposits portfolio;
- diversification and increase in the volume of services.

The further development of banks requires holistic economic reforms which would lead to economic growth and the successful development of the private sector. The growth in economic activity needs to be supported by investments and banking loans. Crucial steps toward the improvement of the economic situation have been taken by the government via improvements in tax discipline and by reducing the share of the shadow economy. As the result, a certain amount of money moved into the banking sector.

Existing banking legislation is harmonized with that of EU. It provides no restriction for the opening of foreign branches in Georgia. According to IMF requirements, Georgia abolished all restrictions on the repatriation of capital. In conclusion, it can be inferred that the banking sector is one of the most favourable sectors for investments in Georgia.

TRANSPORT

Georgia's geographic location, bridging several economic regions, provides it with a unique competitive advantage as a transit country. Situated at the crossroads between Europe and Central Asia, it functions as a natural transport corridor between the West and the East. Georgia is the shortest transit link for the transportation of raw materials, goods, gas and oil from Azerbaijan and Central Asia to the West, as well as western goods and commodities on their way to Central Asia. At the same time, Georgia functions as the vertical North-South transportation link between Russia and Turkey and, via Armenia, to Iran.

The Black Sea ports, in conjunction with the well-developed railroad and highway system, oil and gas pipelines (both existent and under construction), airports and airfields of Georgia – constitute the vital infrastructure that connects vast markets and regions. These infrastructural capabilities represent a strong contribution of Georgia towards the establishment of a trans-regional East-West transport, communication and energy corridor, which in itself is an indispensable precondition for the economic development of the broader Caucasus-Central Asia- region.

Thus, besides its key role in the economic development of Georgia, the development of the country's transport sector is in itself an international project that directly benefits over a dozen other countries.

Opportunities and prospects relating to the function of Georgia as a transport corridor are fully recognized by the international developmental and business communities and also international financial organizations. In response to the pressing need, a number of projects to expand, modernize and develop the transportation sector are currently under way. Transport Corridor Europe-Caucasus-Asia (TRACECA) is undoubtedly the largest project of this kind.

Transport is one of the fastest growing sectors of the Georgian economy. In the period between 1999 and 2003, the turnover in railroad transportation almost doubled (increased by 71.5 %); transportation by road and air increased by 53% and 700% respectively.

The increase in imports to Georgia and transit transportation via Georgia have greatly benefited from such factors as the growing cargo turnover across the East-West transportation axis, the economic growth in Georgia, the policies of the new government that swept away corruption in the Customs Service, as well as improvement of customs administration and simplification of customs and border crossing procedures.

TRACECA

Before the advent of ocean travel in the 15th century – a great technological breakthrough that made the world smaller – the legendary Great Silk Road was the main transportation artery. Being the shortest route from Europe to Asia, it ensured the flow of goods, people, ideas and knowledge in both directions. In the 1990s, when the ending of the cold war meant that the world once again



became a smaller place, the need for reconnecting East and West via the Eurasian landmass re-emerged with renewed urgency and vigour: the opening of the Central Asian markets and Caspian oil and gas reserves required technically sound and cost-effective solutions for a fast, inexpensive and reliable two-way connection. The mega-project of Transport Corridor Europe-Caucasus-Asia (TRACECA) came as a timely response to this pressing need.

In Brussels, at the 1993 meeting of the European Ministers of Transport, eight countries became member-states of the TRACECA program. The project was initiated within the framework of technical assistance to the newly independent states (TACIS). On September 8, 1998 the "Basic Multilateral Agreement on International Transport for Development of the Europe - the Caucasus - Asia Corridor" was signed by Azerbaijan, Armenia, Bulgaria, Georgia, Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, Romania, the Republic of Tajikistan, Turkey, Ukraine and Uzbekistan.

In more technical terms, the objective of TRACECA is to link the Eurasian inland with other regional transportation systems', thus enabling the exchange of commodities and materials at a rate that would strongly accelerate economic growth in the Caucasus and Central Asia.

The (TRACECA) Program conforms to the strategy of the European Union towards the member-states and pursues the following objectives:

- The support of the political and economic sustainability of the participant countries via provision of access to European and World markets;

- Promoting future regional cooperation between the TRACECA member-states;

- The promotion of all possible use of TRACECA projects as a means to attract investments and funds from International Financial Institutions;

- The promotion of optimal integration of the International Transport Corridor Europe Caucasus Asia TRACECA with Trans-European Networks (TENs).

TRACECA is considered to be the most successful among the regional programs initiated by the European Commission. During 1993-2003, approximately 60 projects (50 technical assistance and 10 investment projects) were implemented within the framework of the TRACECA program. Among other initiatives of crucial importance for the Georgian economy, these included the construction of the vitally important new Red Bridge on the border between Georgia and Azerbaijan and the establishment of a ferry terminal in Poti Port that provided a highly convenient and economic permanent ferry connection to Ilyichevsk (Ukraine) and Varna (Bulgaria).

The TRACECA project, which itself resulted from the common economic needs of a dozen of countries, turned into a powerful tool of economic integration within and among the regions of Central Asia, the South Caucasus and the Black Sea basin. The pragmatic need for the reduction of the time and costs of transportation gave impetus to a

multifaceted process of integration that includes:

- the harmonization of specific areas in legislation;
- the harmonization of customs procedures;
- the creation of a unified transport policy;
- the establishment of compatible technological standards.

In fact, within a short period of time TRACECA became no less than a vehicle of economic integration between states of very different political and economic profiles.

From the Georgian perspective, the major benefit of TRACECA is that it creates essential preconditions for economic growth and mutually beneficial foreign trade with economic partners in both Europe and Central Asia. As an unintended consequence, the revived Silk Road facilitates the exchange of ideas, knowledge and culture, as did the ancient Great Silk Road.

GEORGIAN RAILWAYS

Georgian Railways— the oldest system of railroads in the region – dates back to 1865. Linkage to the port and Baku oil fields quickly transformed it into the major transportation artery for the export of wool, cotton, oak, silk cocoon, manganese and Azeri oil via Georgia's Batumi Seaport.

General Technical Characteristics

The railways in Georgia are laid to the standard Russian gauge of 1520 mm. Mixtures of concrete and timber sleepers are used with heavy section flat bottom rail. The railroad accepts an axle load of 23 tones. Station railroad length is 867 km, while operational railroad length is 1565 km; Total railway network length is 2 554.25 km; 1 268 km single track and 297 km double track.

Connectedness to International Railroad Networks

The Georgian railroad is directly connected to the railroad systems of Armenia, Azerbaijan and Russia. Rail-ferry connections in the Batumi and Poti ports link Georgia's railways to the Georgian Black Sea ports of Poti and Batumi are equipped with railway ferry and Ro-Ro terminals and permanent rail-ferry lines which directly connect Caucasus and Central Asia with the Black Sea ports. Poti Port boasts permanent railway ferry connections with the ports of Constantza (Romania), Varna (Bulgaria) and Samsun (Turkey). Work is in progress to convert the rail-ferry operations to European gauge. Poti Port offers permanent railway ferry connection with the ports of Burgas and Varna (Bulgaria) and Ilychevsk (Ukraine).

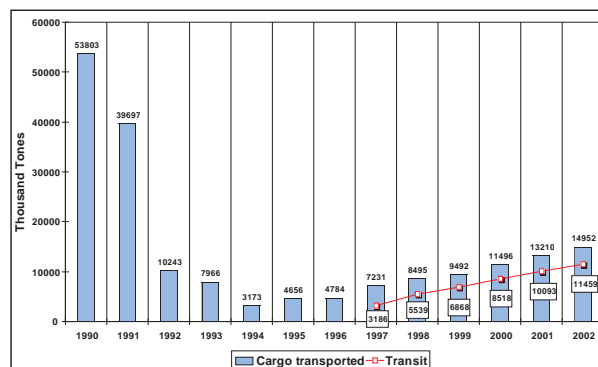
The rail-ferry connections of the Georgian ports, which link them to the Trans-European transport network, afford the opportunity for railway transit to Asia via Baku Port in Azerbaijan, Turkmenbashi Port in Turkmenistan and Aktau Port in Kazakhstan.

Trends in Turnover

Post-Soviet political turmoil resulted the sharp decline in cargo turnover from 54 million tons in 1990 to 5 million tons in 1995. In 1995 approximately 50% of cargo was Humanitarian aid for Georgia and other countries of the South Caucasus. Since 1996 this downward trend has been

followed by steady increase. In 1997 the total turnover reached 7 million tons and in 2002 achieved 15 million tons (see Chart 1).

Chart 1: Trends in Freight by Georgia's Railroad System.



Source: Ministry of Economic Development

In addition to an upward trend in railroad transportation in Georgia, the chart illustrates that the full potential of Georgia's railroad system is far from being utilized, and that the current infrastructure is capable of servicing increasing flows of cargo.

BLACK SEA PORTS OF GEORGIA

PORT OF POTI

52 David Agmashenebeli St.

Poti, Georgia

Tel.: (995 393) 206 60

Fax: (995 393) 206 88

e-mail: mail@potiport.com

www.potiport.com

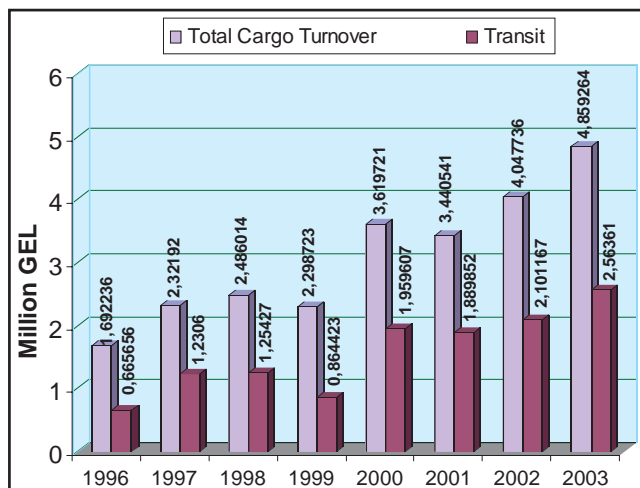
Poti, one of the oldest port cities in history, dates as far back as the 7th century B.C. The modern Port was constructed in 1907.



The port occupies 49 hectares and operates throughout the year, including weekends. At present, the port owns the cargo handling complexes on the 14 berths, which have a total length of 2650 m. 11 berths are equipped with portal

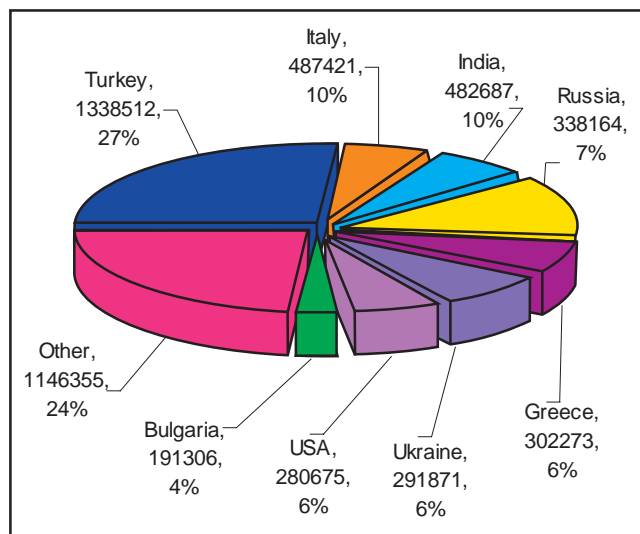
cranes which have a capacity of 6-40 tones and which are linked by railroad. The cargo handling facilities of the port are sufficient to manage virtually all types of cargo, such as general and bulk (ore, grain, scrap, bauxite, coke etc.), 20' and 40' containers and different kinds of liquid (gasoil, gasoline, petroleum etc.). The turnover of the Port is increasing steadily.

Chart 2: Total Cargo Turnover – Poti Port



Source: Ministry of Economic Development

Chart 3: Breakdown of Turnover by Country



Source: Ministry of Economic Development

The government of Georgia is currently considering the option of privatising Poti Port.

PORT OF BATUMI

20 Gogebashvili St.

Batumi, Georgia

Tel.: (995 88 22) 7 62 60/61/64

Fax: (995 88 22) 7 67 80

e-mail: bsport@batumi.net

<http://batport.batumi.net>



Batumi Port was established in 1878. Since then it has been in a process of ongoing development, and has become principally oriented towards bulk cargoes, although its capacity for dry cargo processing has increased rapidly.

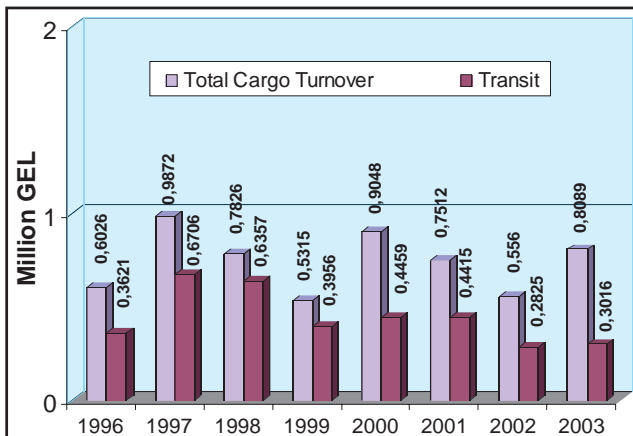
The port operates throughout the year and is characterized by a secure and stable navigation environment. Batumi port chiefly handles oil and oil products through its 4 berths. These occupy eight hectares and have a total length frontage of 755 metres. Dry cargoes are processed by 5 basic and 2 auxiliary berths which occupy 17,5 hectares and have a total length of frontage of 1 590 metres.

Port carrying capacity:

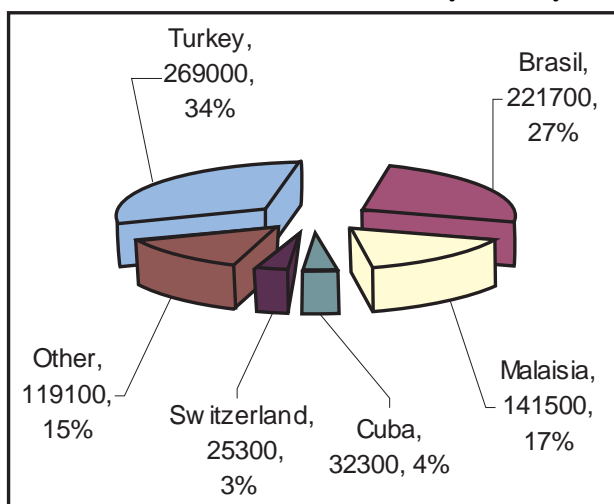
Oil products – 15-18 million tones a year;

Dry cargo – 2,3-2,5 million tones a year.

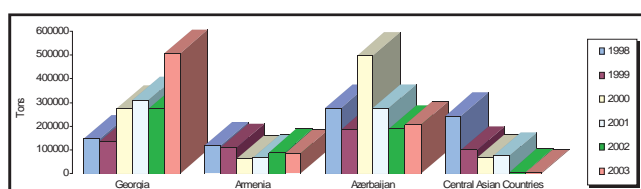
Chart 4: Total Cargo Turnover – Port of Batumi



Source: Ministry of Economic Development

Chart 5: Breakdown of Turnover by Country

Source: Ministry of Economic Development

Chart 6: Breakdown of Turnover by South Caucasus-Central Asia Countries

Source: Ministry of Economic Development

ROAD TRANSPORT

The total length of Georgia's highways is 20 229 kilometres, of which 1 474 kilometres are of international significance. Increasing international transport flow has given rise to new quality requirements in highway maintenance, and thus the renovation and maintenance of Georgia's highways is among the top priorities of government's programme of rehabilitation for the country's infrastructure. Approximately 25% of the roads of International significance will be fully renovated by the end of 2004.



Harmonization of the certification, and technical standards of Georgia with those of EU, recent drastic anti-corruption measures and improvements in customs administration, as well as the introduction of the "green corridor" regime with Turkey, has resulted in an increase in the flow of road transport through Georgia.

CIVIL AVIATION

By joining the Convention of International Civil Aviation Organization (Chicago, 1994) Georgia recognized and legalized the principles and norms according to which civil aviation should develop. Air passengers are served by Georgian and other international air companies, which provide regular flights to and from Georgia.

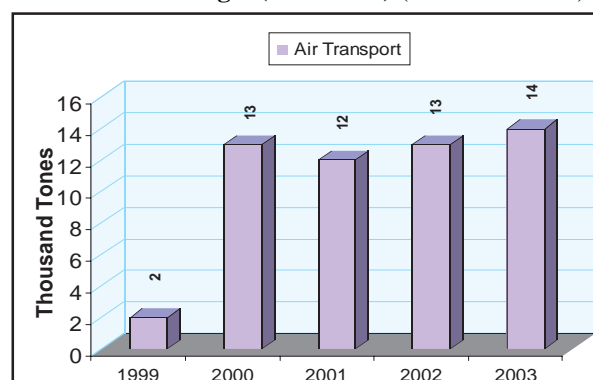
International travel and tourism, coupled with transit flights via Tbilisi, are the driving force in the development of air transport in Georgia. The further development of tourism in Georgia may create a real basis for an increase in the volume of air traffic. As the ICAO experts predict, this figure may reach 600-800 thousand passengers by 2008.



The Infrastructure necessary to meet the growing demand in air transportation is in place in Georgia, although it requires modernization. Georgia possesses operational airports and airfields in at Tbilisi, Kutaisi (Kopitnari), Senaki and Batumi. Tbilisi, Kutaisi (Kopitnari) and Senaki are the predominant facilities, providing 97% of all services. Georgia also possesses numerous secondary and minor airfields.

Direct air connections to Tbilisi are available from the European cities of London, Vienna, Zurich, Athens, Paris, Prague, Amsterdam, Berlin, Frankfurt, Istanbul, Moscow, St. Petersburg and others.

In addition to Airzena, the largest Georgian operator, other major international airlines currently operating in Georgia include Aeroflot, Austrian Airlines, British Airlines, KLM and Turkish Airlines.

Chart 7: Trends in Air Transportation in Georgia (1999-2003) (Thousand tones)

Source: Ministry of Economic Development

FUTURE PROSPECTS

The prospects for expansion and modernization of the transport sector in Georgia are bright. The increasing inflow of cargo and passengers; such international projects as TRACECA; the ongoing modernization of the infrastructure; government policies of de-regulation and effective anti-corruption measures; the harmonization with EU standards of the legislative basis, technical standards and regulations, collectively facilitate growth in the sector. There are various opportunities for foreign direct investment that would accelerate development of the sector and would undoubtedly prove profitable in both the short and long term.



TELECOMMUNICATIONS

For the Georgian telecommunication system the past five year period has been a stage of structural changes targeted at liberalization and integration with the international telecommunication community - one of the priorities of the country.

During 2003, the influence of the telecommunication system on the potential development of the country's other economic sectors dramatically increased. The telecommunication system is one of the main driving forces, promoting the formation of the information- and knowledge-based economy and providing for the stable development of the whole economy and society in general. The telecommunication sector is one of the most pivotal segments of the country's economy, directly affecting microeconomic development prospects.

The revolutionary technological change in communications that took place in 1990s, accompanied by deeper economic integration processes, caused significant changes in the development of the Georgian telecommunication system. This included:

- structural transformation of the telecommunication sector;
- liberalization;
- development of the legal framework;
- formation of a competitive environment within the sector;
- introduction of new telecommunication services and a larger coverage range;
- expansion and diversification of services and increased access.

DEVELOPMENT OF THE GEORGIAN TELECOMMUNICATION MARKET

The current function of Georgia as the international communicational highway connecting Europe and Asia serves as a driving force for progress in telecommunication. The process of linking the Georgian telecommunication system to the integrated international infrastructure implies the introduction of modern communication technologies and the development of the relevant profile segment for servicing the infrastructure. Creation of an appropriate communication service system for international transporta-

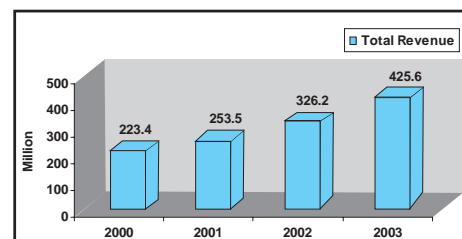
tion, commodity, monetary and information flows plays a decisive role in the ongoing structural transformation of the country's economy.

The current processes of global economic integration create the demand for horizontal development and expansion of the telecommunication infrastructure at the national, sub-regional and international levels. Georgian legislation on communications and postal services is based on international market principles and provides for the comprehensive development of the telecommunication sector.

THE GROWTH TREND IN THE GEORGIAN TELECOMMUNICATION MARKET

Starting from the year 2000 the Georgian telecommunication sector became more and more attractive for investors not only because of its economic and geographic importance, but also as a result of the growth in the telecommunication market and the subsequent increase in revenues received by the operators. In 2003, the total revenues of operators working in different segments of the telecommunication sector almost doubled (90.45% growth) in contrast with the revenues received in 2000. Compared to the previous year, the revenue growth rate in 2001 was 13.4%, in 2002 - 28.7%, in 2003 - 30.4%. The total amount of revenue in the sector in 2000 was 223.4 million GEL, in 2001 - 253.5 million GEL, in 2002 - 326.2 million GEL and 425.6 million GEL by the end of 2003 (see Chart 1).

Chart 1.: Total Revenue (mln. GEL)

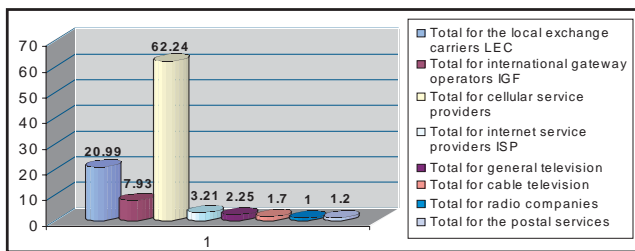


Source: Ministry of Economic Development

The revenue structure analysis of the Georgian telecommunication market demonstrates that cellular telecommuni-

cation services receive the largest share of revenues – 62.2%, while the revenue of the local exchange carriers is 21% (see Chart 2).

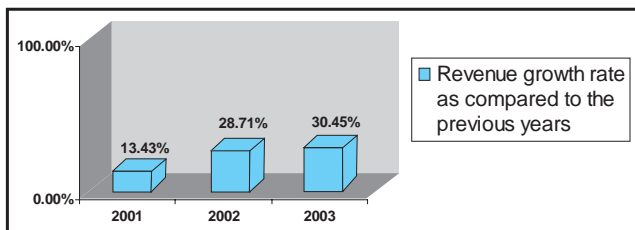
Chart 2: Shares of Telecommunication Operators in the Total Revenue of the Market (per cent)



Source: Ministry of Economic Development

The largest share of the total annual revenue growth was observed both in the cellular telecommunications sector – 40.3% and internet services – 71%.

Chart 3: Revenue Growth Rate (per cent)

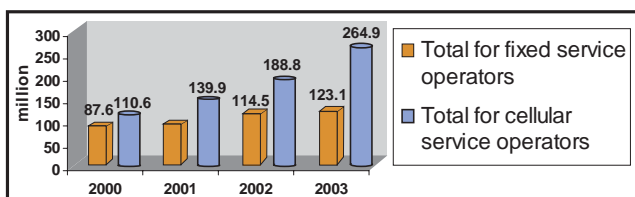


Source: Ministry of Economic Development

LOCAL EXCHANGE CARRIERS

In 2000 – 2003, the Georgian Regulatory Commission issued 18 licenses to providers of local telecommunication services. Currently “Sakartvelos Elektrokavshiri”, Ltd “Akhali Kselebi”, and “Akhteli” Ltd. occupy the biggest market segments. In 2000 – 2003 the total number of telephone lines owned by these operators increased from 510 000 to almost 600 000, while the number of customers increased by 20% and reached 497 000. By the end of 2003, the density of registered customers in Georgia increased by 4.7% -- to 15.4 per 100 citizens. In 2003, the total revenue received by the local exchange operators increased to 89,3 million GEL, which is 42.8% higher compared to the year 2001 (see Chart 4). The share of revenues received by the local exchange operators was 21% of the total revenues in the sector.

Chart 4: Revenues of Local Exchange Carriers and Internet Service Providers (mil. GEL)



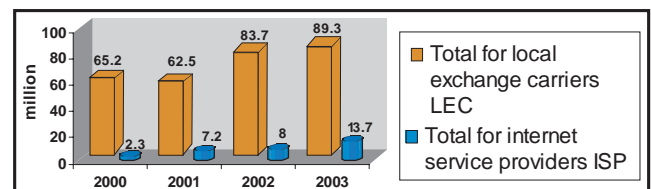
Source: Ministry of Economic Development

An increase in internet services was also a significant. At the end of 2003, the revenues received by internet service providers increased by 70.8% compared to the previous years and reached almost 14 million GEL. In 2003 the number of internet users reached 123 000.

CELLULAR TELECOMMUNICATION SERVICES

There are two main cellular telecommunication service providers operating in the Georgian market: “Magticom” Ltd. and “Geocell” Ltd. Both companies use GSM systems for their networks. The growth of this segment is one of the highest parameters of the Georgian telecommunication sector. In 2000, the amount of revenue received by the cellular service providers was 110 million GEL. This figure increased during the following three years and by the end of 2003 was almost 140% higher than in 1999, equalling 264.9 million GEL (see Chart 5). It must be noted that in 2003 the total revenue of cellular service providers was 62.2% of the sector’s total revenue. The revenue growth was a result of the increasing attractiveness of cellular services and the growing number of customers of the operating companies. The growth rate of the number of customers’ is also noteworthy. According to the data for 2003, the number of registered users cellular service users grew by approximately 140%, from 188,8 to 264.9 mln. GEL. By the end of 2003 the cellular communication services covered 95% of the populated area of the Country. If in the year 2000 the density of cellular service users was 3.65 per 100 persons, by the end of 2003 this number had reached 13.49 and equalled the density of customers of the telephone network.

Chart 5: Revenues of Cellular Telecommunication Service Providers (mil. GEL)

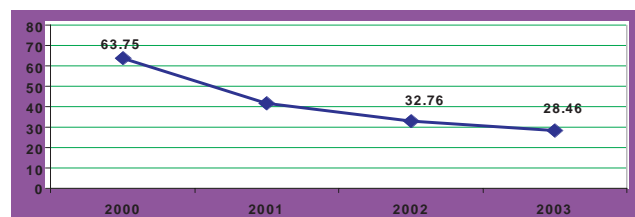


Source: Ministry of Economic Development

While the total revenues of the cellular service providers increased in 2000-2003, the average revenue per one customer was falling (see Charts 5, 6 and 7). The average annual revenue per customer was 63.75 GEL in 2000, but dropped to 28.46 GEL as of December 2003 (Chart 6). The number of customers of cellular service providers is growing at a higher rate than the rate at which the revenues received per customer are falling. The formation of the customer base of the cellular service providers started in the late 90s. At the initial stage of formation, when the prices of personal mobile phones were higher, the demand for cellular communication services increased mostly at the expense of “leader” customers. Later on, the second cycle of growth started when “innovator” and “imitator” customers became potential users of cellular services. This was promoted by the drop in mobile phone prices and the formation of the market for second-hand mobile phones. The inflow of potential “innovator” customers lasted from June 2000 until

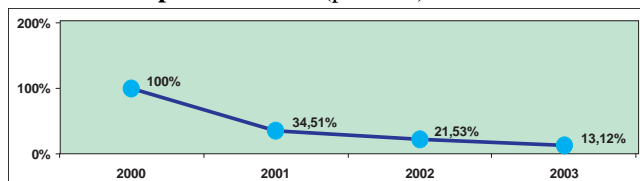
October 2001. At the end of 2001 the growth of the largest market segment started, which has the greatest potential for further growth.

Chart 6: Average Revenue Per Customer (GEL)



Source: Ministry of Economic Development

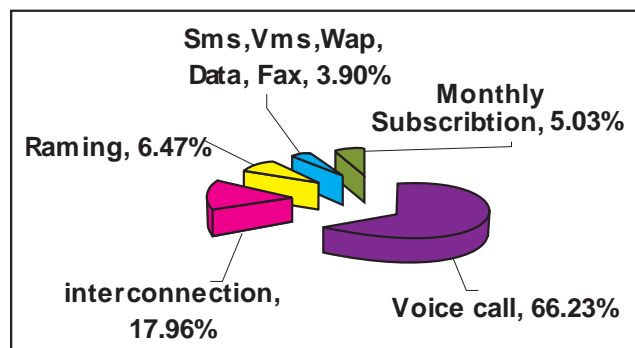
Chart 7: The Rate of Reduction of Revenues per Customer (per cent)



Source: Ministry of Economic Development

In 2003, voice communication formed the biggest share of revenues in the total revenue structure received from various types of cellular services – 66.23%. In 2000, the same parameter totalled 57.7%. In 2002, it rose again to 73.44% (see Chart 8).

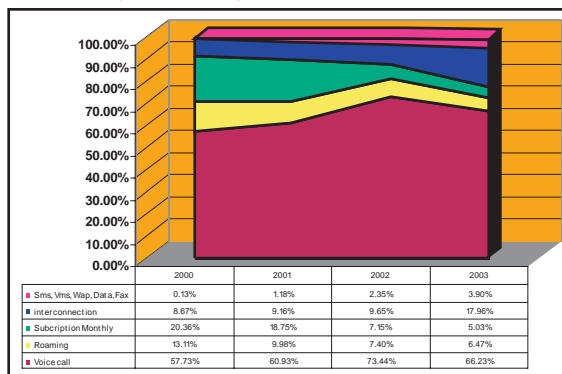
Chart 8: Structure of the Revenues in 2003



Source: Ministry of Economic Development

Between 2000 and 2003 the revenues received from different types of services (such as SMS, VMS, WAP, MFAX, GPRS, DATA) increased from 0.13% to almost 4%. In order to be able to assess the attractiveness of implementing the systems of the third generation, analysis of this parameter is important (see Chart 9).

Chart 9: Trends in Structure of Revenues (2000-2003)

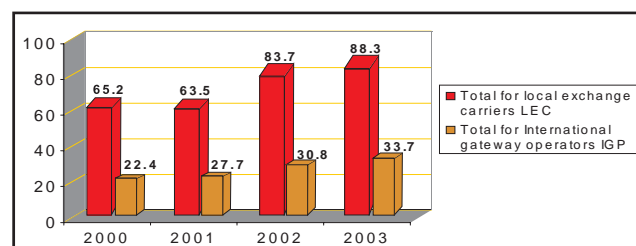


Source: Ministry of Economic Development

INTERNATIONAL GATEWAY FACILITIES

In 2001, the Georgian Regulatory Commission for Telecommunications issued 10 licenses permitting the operators to provide international telecommunication services; in 2002 – 8 licenses and 5 more in 2003. The trend of total revenue increase was visible in this service segment too. According to the data of 2003, the total revenue of international gateway operators increased by 9.6% as compared to the previous year's and reached 33.7 million GEL (see Chart 10). It must be noted that the revenue increase took place while the average tariffs dropped. The share of revenues received from international communication services was 7.93 % of the sector's total revenue.

Chart 10: Revenues of Local and International Telecommunication Service Operators (mln. GEL)



Source: Ministry of Economic Development

POSTAL SERVICE

The postal service that covers the whole territory of the country varies from region to region according to its organization structure, administration rules and geographic conditions for providing services. Within Georgia, the internal postal service provider is "Sakartvelos Posta" Ltd. There are up to 15 operators providing international postal services.

In 2000 the postal service revenues totalled 4.4 million GEL, while in 2001-2002 this number rose to 5.9 million GEL. In 2003 the revenue dropped to 5.1 million GEL but this figure is still considerably higher than the same parameter for the year 2000.

The growth of the Georgian telecommunication sector in 2002-2004 was a result of the systemic reforms carried out in the country. The liberalization achieved in the telecommunication sector during the reform, the development of a favourable legal basis, the increase of competition



in the market, and the implementation of the modern IT technologies created preconditions which support the formation of that sector of the economy. The investments made in the telecommunication sector during recent years were targeted at the implementation of innovative information/communication technologies and growth of the traditional communication (telephone) services. Replacement of the obsolete equipment inherited by the country with mod-

ern digital systems was one of the characteristic features of the ongoing restructuring of the sector.

The "Digital Divide" is becoming progressively smaller in the country, in its attractive segments (big cities and regional centres) as well as in rural area. The quality of services provided by the operators has increased significantly and the services have become more diverse. The factors and mechanisms effectively stimulating the demand have become more influential. Taken together, these stimulated investments in the Georgian IT sector and facilitated the growth of the market. Analysis of the current data reveals that, in Georgia, the estimated investment potential in the information and communication sector segments amounts to USD 300-350 million. Strategic priorities for investments in the information/communication sector correspond to the international economic comparative advantages of the country – its functions in transit and interconnection between the eastern and western information and communication zones

Today, under the current conditions of boosting technological changes, the growing necessity for international transportation and commodity, monetary and information flows at regional and trans-regional scales provides many possibilities for beneficial investment projects, which will create an internationally integrated communication network in Georgia.

ENERGY

NATURAL RESOURCES

Georgia possesses significant hydro-electric and geothermal resources, and considerable reserves of fossil fuels as well as high potential for developing renewable energy generation facilities.

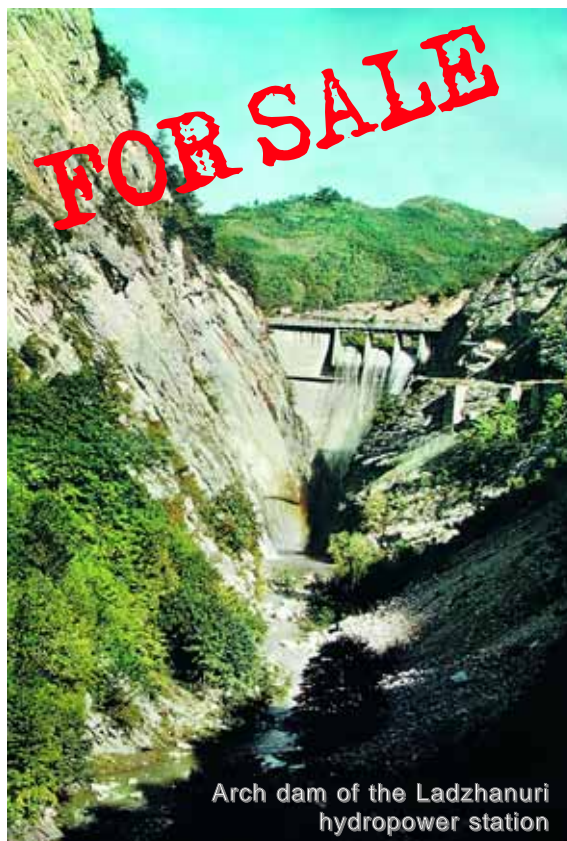
HYDROELECTRIC RESOURCES

Hydroelectric generation constitutes about 80% of Georgia's electricity balance and will continue to play a major role in the country's energy plans in the foreseeable future, primarily because of favourable conditions for hydroelectric generation. There are 26 thousand rivers with a total length of 60 thousand kilometres and 319 rivers with a potential of 15.63 million kWh and average annual production of 135.8 bill kWh. About 85% of hydro capacity is concentrated in Western Georgia. Georgia's power system currently includes a large amount of energy storage in the hydro reservoirs.

FOSSIL FUELS

The Georgian oil & gas sector is very mature and has gone through both ups and downs during its 74-year history of exploration, production and development. The peak of oil production was in the 1980s when it reached 3, 3 million tons.

At the moment there are 16 oil & gas fields being jointly developed in Georgia (14 – oil; 1 –oil and gas; 1 – gas condensate). The total estimated oil reserves in place are 580 million tons, of which 193 MM are projected to be in the Georgian basin of the Black Sea. As for the total gas reserves in place, this is expected to be in the Eastern part of Georgia to the total of 98 billion em. By 2000 cumulative oil production in Georgia amounted to 27 million tons. Clearly, there is a significant potential for further exploration and development activities in the Georgian oil & gas sector, both onshore and offshore.



Arch dam of the Ladzhanuri hydropower station

There are three main coal deposits at Tkibuli, Tkvarcheli and Akhaltsikhe. The Tkibuli coalmine constitutes about 80.2 % of the country's total deposit (reserves amount to 282 million tones). The Akhaltsikhe deposits constitute 15.7 and Tkvarcheli 4.1 %.

GEOTHERMAL RESOURCES

Georgia is a country where there are considerable resources of middle and low temperature thermal water (33 - 108⁰ C). At present, geothermal energy is used in Georgia only for heating supply. The total resources of thermal energy in Georgia constitute:

- Resources currently in use - 350 MW;
- Unused; proven resources - 465 MW;
- Theoretical resources - 1800–2000 MW.

The main geothermal fields are located in Western Georgia (reservoir formation is fractured karstic limestone of the upper Cretaceous in the sedimentary trough) and in the South-east (volcanic/sandstones Palaeocene-middle Eocene in the folded system).

RENEWABLE ENERGY POTENTIAL

Apart from the rich hydro resources, non-traditional renewable energy resources in Georgia are extensive and potentially provide the basis for the substantial development of solar power and wind power, as well as geothermal and bio energy production. The potential for wind energy is estimated at 2,300 MW. As yet no operative wind energy capacity exists, except for a few 6 kW units. A wind atlas of Georgia identifies four main areas where wind farms could generate sufficient power:

- The high mountain zone of the Caucasus;
- The Mtkvari river valley;
- South Georgian highland;
- The southern part of the Black Sea;
- These areas have an average annual wind speed of more than 6 meters/second at 30 m height.

Regarding solar energy, despite significant potential, it is currently not in wide use in Georgia. In Tbilisi, the total radiation incident on horizontal surfaces is on average 5048 MJ/m² and the direct solar radiation incident on surfaces normal to sunlight beams is 4 905 MJ/m².

Georgia has some biomass resources due to a climate favourable to forestry and agriculture. In some regions, it is possible to obtain two yields per year. Biomass is considered an important source for power supply, especially in rural areas.

PRIMARY ENERGY CONSUMPTION

Georgia's primary energy consumption (PEC) in 2000 was slightly less than 3 million tons of oil equivalent (mtoe):

- Petroleum – 47%;
- Natural gas – 32%;
- Hydropower – 17%..

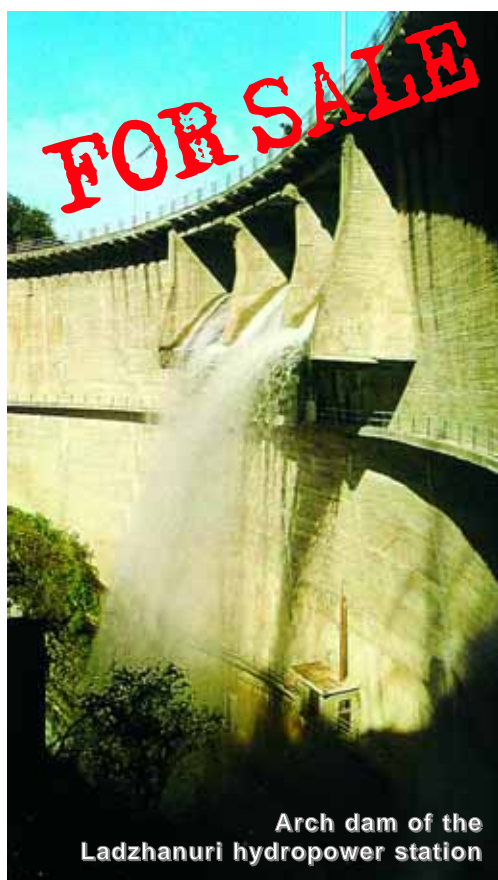
Domestically-produced energy accounts for around 26% of the total PEC. Excluding hydro production, the remaining 9% of domestic energy is split between 4% oil, 2% gas, 3% geothermal energy and firewood and 0.4% coal.

INFRASTRUCTURE

At the moment, installed power generation capacity in Georgia is about 4 800 MW, although the best estimate of available capacity is 2 400 MW. 2,800 MWs of Georgia's total installed generation capacity is hydroelectricity, distributed among 15 hydro plants, and about one hundred smaller units. Seven of the larger hydro plants have reservoirs with capacity for annual regulation. Four plants have only daily regulating capacity. The largest reservoir of the system is at Enguri, with a dam height of 271.5m and a nominal capacity of 667 mcm. Enguri HPP represents 68% of the total storage capacity and has an installed capacity of 1 300 MW, currently producing about 30% of total system output. Vardnili, the second largest installation, has an installed capacity of 220 MW.

Total generation in Georgia has decreased significantly (about 35 %) since 1992. This results from a sharp decline (70 %) in thermal generation, caused by lack of maintenance and funds. In contrast, hydro generation has remained relatively stable (apart from a temporary decline in 1994). Georgia's largest thermal plant is "Tbilsresi", south-east of Tbilisi at Gardabani. This plant originally had ten units with a total installed capacity of 1 850 MW, where two parts have separate owners: the Georgian State via Tbilsresi and the Russian investor RAO UES. The State owns 8 units of 150 MW each, only three units are operational. At a maximum, each unit can provide about 130 MW. RAO UES owns 2 for 300MW installed capacity, the last restored for gas operation.

At present, current peak demand does not exceed 1 800 MW, while current base demand is 600 MW. In winter, however, available capacity has not been able to meet peak demand. The network consists of a physical infrastructure that is, in the main, almost fully depreciated, having received extremely little maintenance since Georgia's independence.



Georgia's high voltage transmission system is composed of 576 kilometres of 500 kV, 1690 kilometres of 220 kV and 3911 kilometres of 110 kV. Georgia's power system is interconnected with the systems of neighbouring Russia, Turkey, Armenia and Azerbaijan.

Currently, Georgia is strongly dependent on gas imports to keep its economy running. During the Soviet period, Georgia developed its gas transmission network intensely. Gas became the main fuel in Georgia, and gas consumption peaked in 1990 with 6 bcm, when gas accounted for about 60% of the total energy consumption. At present Georgia receives gas only from Russia. The core part of the system is the North - South pipelines from the Russian border to the Armenian border. The largest volumes are transported in the DN 1200 and DN 1000 pipeline, constructed during 1980-1994. Parallel to this line an older DN 700 and DN 500 line is located, to which the meter- and regulator stations supplying the Georgian market are connected. Main gas pipelines in Georgia have a total length 1,940 km. The total geometric capacity (gas pipelines accumulation possibility) slightly exceeds 550 000 m³.

The establishment of a common legal basis for the development of oil and gas resources contributed to the acceleration of progress in the oil industry, and was instrumental in the implementation of governmental policy. The "National Oil Company of Georgia – Saknavtobi", carries out large-scale research and survey operations jointly with foreign companies. The efforts made by the joint ventures led to the suspension of oil production rates reduction and an increase in the production rate to 100 000 tones. As a result of this Georgia has produced 560 500 tones of crude oil and 30.4m cubic meters of gas between 1995 and the present. As a result of the operation of the Georgian-British oil company "Ninotsminda", it became possible to resume gas production at the Ninotsminda field in Georgia in 1999. It is notable that in order to increase hydrocarbon production rates the company started preparatory work on the drilling of new horizontal wells.

Concerning gas storage facilities, Georgia has high potential for developing underground formations for this purpose. Two geological areas have been identified as good options for long term storage: the depleted or partly depleted oil fields in Eastern Georgia and a large aquifer belt on the Black Sea coast. Most of the selected fields are exhausted or partly exhausted oil and gas condensate reservoirs.

MARKET

In general, power consumption has followed the decline in generation, which was absorbed by the deterioration of industrial consumption. The proportion of the industrial customer category has decreased substantially since 1990, replaced by the residential and commercial category, which has come to constitute the bulk of total consumption in recent years.

Insufficient cash flow caused by ineffective electricity revenue collection determined the ability to pay for generated power, and gas deliveries to power plants. Thus a combination of technical and commercial factors has caused the highly irregular supply and distribution of electricity. Despite decreasing availability and efficiency of hydropower generation units there has been an almost constant annual output of electric energy of around 6 000 GWh (million kWh) during the past 10-12 years, whereas the consumption is around 7,27 million kWh. The maximum and minimum output was approx. 7 600 and 4 800 GWh respectively. In total, only 40-45% of design capacity is used by the hydropower plants due to lack of maintenance and investment. Rehabilitation of these plants may prove very efficient and worthwhile in terms of gained capacity against investment. One example is the Vardnili hydropower station, which in March 2004 added 70 MW of capacity through the investment of only USD150,000.

The power sector is structured around the Georgian Wholesale Electricity Market (GWEM), currently under management contract with the "Iberdrola" consortium, which acts as a clearinghouse.

Transmission and dispatch are combined into one company, Georgian State Electrosystem (GSE), under management contract with ESBI. Distribution is divided into Tbilisi (Telasi – 75% owned by RAO UES), Ajara, Apkhazeti, Kakheti (privately held), and the United Distribution Company (UDC). UDC covers the rest of Georgia, and is managed by PA Government Services. Tbilisi Distribution Company (covering 34% of the market) has significantly increased the collection

rate thanks to the major investments made during recent years. The UDC is newly established and till now has suffered severe problems, notably a poor network and a low collection rate. The project envisages achieving a collection rate of about 42% in 2005, and 75% upon completion of the UDC's boundary metering program (wholesale purchase points).

Concerning the gas sector, during the years 1989-1990 Georgia's annual gas consumption peaked at 6 Bcm. If the



transit volumes to Armenia are taken into consideration, the total annual flow in the system peaked at 7 Bcm in 1992. Since then the annual flow has dropped dramatically. During the last 7-8 years, the annual gas flow has been stable around 2.5 Bcm, which is only 12.5% of the design capacity. With a monthly load factor of 0.7 this corresponds to a working design capacity of 3.6 Bcm per year = 209 mcm per month = 7 mcm per day and 290 000 m³ per hour. As was mentioned above, the current gas demand has dropped to 1 bcm, although this represents around 30-35% of the total energy consumption.

PRIVATIZATION

The first steps towards privatization were made in 1998 when one of the largest American corporations, AES, expressed its interest with regard to the Tbilisi distribution grid. Currently, the Russian investor RAO UES owns the Tbilisi distribution grid as well as Gardabani 9th and 10th thermal units. At the same time the company has been granted a twenty-five-year Management contract for Khrami 1 and Khrami 2 HPPs. A Georgian company privatized the Kakheti distribution enterprise. The Tetsi Plant, a small thermal PP with 18 MW installed capacity was purchased by Sakgazi in late 1999.

In the continuing effort to privatize electric enterprises, the Georgian Government is offering for sale (more than 50% of equity in each company) or for long-term concession (more than 25 years) all generation plants larger than 15 MW installed capacity. The hydropower generation assets to be privatized consist of the following power plants:

- Gumati (installed capacity 44 MW with 4 original units);
- Lajanuri (installed capacity 111 MW with 3 original units);
- Rioni (installed capacity 49 MW with 4 original units);
- Shaori (installed capacity 38, 4 MW with 4 original units);
- Tkibuli (installed capacity 80 MW with 4 original units);
- Their installed capacity ranges from 38 MW to 112 MW.

The privatization of most of the sector's remaining distribution enterprises is now under way. It was decided to offer the United Distribution Company for management contracts as the most expedient way to ensure its commercialization prior to its privatization.

TRANSIT AND FUTURE PROJECTS

Georgia will remain a transit country for natural gas. Russian gas transported to Armenia is via a long-term inter-governmental contract. The transit fee is 10%. For the period 1992-2000 the volume of gas has varied between 1.25 and 2.25 Bcm annually with transit fees of 125-225 mcm.

The transit pipeline efforts achieved a milestone in April 1999 when the "early oil" pipeline from the Caspian Sea to the Georgian Black Sea port of Supsa became operational. Estimates of the Caspian Sea Region's proved crude oil reserves vary between 17 and 33 billion barrels. In 2002, regional oil production reached approximately 1.6 million

barrels per day. The development of the region's oil resources has been led by the region's three major pipeline projects, the Caspian Pipeline Consortium Project (CPC), the Baku-Tbilisi-Ceyhan oil pipeline (BTC), and the South Caucasus Pipeline System – natural gas pipeline also known as Baku-Tbilisi-Erzurum (BTE). The pipelines are establishing the framework for the new energy transportation axis.

BAKU-SUPSA PIPELINE (CPC)

The Baku-Supsa pipeline is the first large-scale transit project implemented in Georgia since the restoration of independence. The pipeline transports "early oil" from the Caspian Sea region operated by AIOC consortium off the Azerbaijan coast. Initial Line Capacity is 5,75 mt/year (115 000 b/d) but could be increased to approximately 10 mt/year (200 000 b/d)



with additional pumping stations. The pipeline runs 814 km from Baku to Supsa (444 km Azerbaijan in and 370 km in Georgia). The original cost of the project was estimated at USD 315 million, but escalated to USD 590 million. There are four 40 000 tonne storage units at Supsa.

Georgia also serves as a transit corridor for Kazakh oil, which is produced by the Chevron-led TCO consortium at Tengiz. Crude oil is transported by barge across the Caspian Sea to Dupendi (near Baku), and then moved by a combination of railcars and pipelines to Supsa. In 1998, about 2,2 mt of Kazakh oil were transited through Georgia.

BAKU-TIBLISI-CEYHAN OIL PIPELINE (BTC)

The Baku-Tbilisi-Ceyhan oil pipeline (BTC) is designed to transport Caspian oil: up to one million barrels of Azerbaijani oil per day (bpd) - 50 million tonnes per annum, via Georgia to the Turkish port of Ceyhan on the Mediterranean. The estimated cost of the pipeline is USD 2.9 billion. The pipeline will extend 1750 km across all three countries. In Azerbaijan the pipeline has a length of 442 km, in Georgia it is 248 km and in Turkey - 1060 km. The 42" (1,066.8 mm) diameter pipeline in Azerbaijan converts to 46" (1,168.4 mm) diameter as it enters Georgia and reverts to 42" diameter in Turkey.

SOUTH CAUCASUS PIPELINE SYSTEM (BTE)

The South Caucasus Pipeline System project envisages the transportation of 2 bcm in year one, 3 bcm in year two, 5,5 bcm in year three and 6,6 bcm from year four up to year fourteen. As part of the transit payment, Georgia will receive 5% of the volume of natural gas transited from Azerbaijan to Turkey. Over the 40 years of the entire project life, approximately 950 BCM of natural gas will be transported. Respectively, proceeding from the project parameters of the SCP project, over the 40-year operation period, Georgia will receive 50 BCM of natural gas as an in-kind payment for transit. The supplemental gas is to be supplied to Georgia from Azerbaijan as a part of the transit payment at a special predetermined price – USD 55/1000 m3, with a yearly indexation of 1,5%.

UNIFIED GAS SYSTEM

Establishing a Unified Gas System (UGS) facility has the potential of optimising the benefits of those new supplies of gas, in addition to the gas that is imported from Russia and the transit fees that are received from transiting gas through Georgia to Armenia. Today, Georgia has a rather unique combination of a high share of gas in the total energy consumption, no diversification in technical supply with only one supplier and no domestic storage capacity. As a result, Georgia's SoS-index (Security of Supply) comes out as the third lowest of the countries that have been analysed. By establishing a UGS facility with a

capacity of 1 month's gas consumption, the SoS-index will increase by a factor of 2 but Georgia will still be ranked below the average index parameter. By adding Azerbaijan as the second gas supplying country through the SCP pipeline the SoS-index will increase again by a factor of 2, which will bring Georgia's score close to the median value of the SoS-index for all the analysed countries. Investment estimates and economic analyses have indicated that the unit costs of gas storage operations in the most feasible scenario would be comparable with, if not more favourable than, storage fee rates charged by European gas storage operators for storage services of similar flexibility, i.e. daily withdrawal rates at around 1.5% of the annual total withdrawal volumes. Investment needs ranged between 60 mln. EUR for the cheapest and smallest facility (120 mcm working volume) and 93 mln. EUR for the most feasible facility (480 mcm working volume).

FUTURE PROSPECTS AND OPPORTUNITIES

Georgia, with its excellent geo-political location, can serve as the hub of transit lines from countries with energy surpluses in the north to countries with energy deficits in the south. For a better quality of electricity transit and transmission, Georgia needs to construct a back-to-back high voltage DC (Direct Current) substation with Armenia and a 500 kV line to Turkey with same type of substation. Such transit lines would have a significant positive fiscal impact for Georgia's economy and for improved energy security. The transit line to Turkey could serve as a connection line between Russia's excess energy system and the deficit systems of Turkey, Iran, etc. The Government of Georgia intends to announce a tender in the nearest future for a company that will manage the construction of this North-south power transmission line, and which will also manage Tbilisres (the state-owned Gardabani thermal power plants). Every MWh produced by Tbilisres during the winter months will be returned with some interest to the company after the construction of the line for export to Turkey. Such an arrangement could prove profitable for an investor and at the same time enhance the energy security of the

country. Georgia would seek contracts to exchange its excess summer hydro energy against energy from mainly thermal power systems during the winter.

Another project that the government is considering offering to potential investors is the construction of the Khudoni Hydro plant. The construction of this plant will secure the energy supply of the country throughout the



Shaori hydropower station

year through its own resources. Khudoni will generate 1 billion KWh and will allow Enguri to generate an additional 1 billion KWh as the Khudoni reservoir will be located on the same river above Enguri, and the supply of water to the Enguri reservoir will be better regulated. Construction of the Khudoni HPP will cost USD 500 – USD 600 million and will last 4-5 years. Any investor will be obliged to sell the produced electricity to Georgia during winter months and to export it during spring and summer.

The existence and use of hydro production and reservoirs represents an asset for Georgia's power system. A major advantage for Georgia in the future regional competitive power market is the cost-efficient hydro resources which can be made available for export, especially during the summer period. During the last decade or more, Georgia never exported its electricity except for debt repayment purposes. Currently, Georgia is seeking potential mar-

kets for electricity exports during the summer months, which will help the country to accumulate funds or rights for future imports during the winter shortage period.

ESTIMATE OF FUTURE PROSPECTS

Sound market principles will facilitate improvement in the financial management of the power sector. A favourable

investment climate and the attractive opportunities in electric power generation for Georgian and regional markets will attract foreign direct investment. This, together with transit projects, will strengthen the energy security of the country and will strongly support economic growth and macroeconomic stability in Georgia.

TRADE POLICY AND EXTERNAL TRADE

Georgian trade and exchange systems rank among the most liberal among the transitional economies. Unsurprisingly, due to the size and openness of the Georgian economy, foreign trade plays a considerable role in the stability and growth of economy.

The IMF's trade restrictiveness index (TRI) for Georgia is currently as high as 2 on a scale of 1 to 10. In accordance with Georgia's obligation to the WTO, on December 6 of 2002 the Parliament of Georgia adopted the "Law of Georgia on changes to the Law on Customs Tariffs and Duties". Since January 11, 2003 22 different tariff lines from 0 to 30% (0, 2, 3, 4, 5, 7, 8, 9, 10, 12, 13, 14, 15, 16, 17, 18, 20, 22, 24, 25, 27 and 30) are applied. However, the weighted average tariff does not exceed 9-10%. Also, there are seasonal tariffs for some agricultural products, and specific duties for alcoholic beverages. These changes were made in fulfilment of the obligations undertaken by Georgia on joining the WTO in June 2000.

Accession to the WTO was a significant step in the process of transition to a market economy. The process of accession into the WTO was preceded by a series of substantial changes in national legislation in the areas of:

- intellectual property;
- trade-related investment regime;
- trade in services;
- government procurement;
- standardisation and certification issues;
- foreign trade policy regime.

Membership of WTO clearly indicates that Georgia's legislative framework complies with international standards, that trade is liberalized and that foreign investment is welcome. Participation in the WTO has encouraged Georgia's integration with Europe.

External tariffs on the majority of commodities have been reduced in accordance with the so-called "sectoral initiatives" that Georgia had joined. Those initiatives include:

- chemical products;
- timber and paper products;
- rubber;
- steel, agricultural and medical equipment;
- IT products;
- civil aircraft;
- furniture;

- fish and fishery products;
- vegetables.

Increased tariffs mostly apply to food-processing products, alcoholic beverages and tobacco products.

Imported goods are also subject to 20% VAT (to be reduced to 18% according to the draft tax code) and excise tax ranging from 5-100% for products such as alcoholic drinks, ethyl alcohol, jewellery, gasoline, cigarettes, tyres and caviar. Specific excise taxes apply to imported oil products. The customs processing fee amounts to a modest 0.15%. All transit goods are exempt from taxes. Exports from Georgia are free of customs duty and are VAT exempt.

In terms of market access arrangements, as a member of WTO, Georgia is subject to Most Favoured Nation (MFN) treatment. Additionally, the EU, USA, JAPAN, Canada, Switzerland, and Turkey granted Generalized System of Preferences (GSP) status to Georgia.

Georgia has a liberal foreign exchange system with no restrictions on payments and transfers for current international transactions. The currency floats with infrequent market interventions. The National Bank of Georgia performs only one-sided interventions (selling). Because of a lack of other efficient mechanisms for monetary policy, the primary objective of exchange rate policy, as stated by the Bank of Georgia, is maintenance of price stability. A secondary objective is maintaining the international competitiveness of the economy.

EU-GEORGIA BILATERAL TRADE RELATIONS

Georgia and the EU signed a Partnership and Co-operation Agreement (PCA), which entered into force in 1999. According to Article 9 of the PCA the Parties accorded to one another Most Favoured Nation treatment. Georgia enjoyed Most Favoured Nation (MFN) treatment with the EU before it became a WTO member. Since Accession to the WTO in June 2000 Georgia received permanent, unconditional, contractually guaranteed MFN status from all the WTO members. After EU enlargement, the EU-Georgia Partnership and Cooperation Agreement (PCA) has been extended to the new Member States.

Importantly, Georgia has enjoyed the Generalized System of Preferences (GSP) from the EU. The Generalized System of Preferences, by using classical instruments of

trade policy such as tariffs, is traditionally an independent instrument of trade policy, promoting trade. The EU GSP scheme offers developing countries like Georgia preferential access to the EU market for certain goods non-sensitive for the EU market.

With regard to the Georgian trade with the EU under the GSP system, it should be noted that a certain recent upward trend can be observed. If in 2000 Georgian exports into the EU comprised USD 70.4 million and the GSP treatment was granted with regard to goods to the value of USD 18.5 million, by 2003 Georgian exports grew to USD 76 million and the value of exports performed under the GSP totalled USD 42 million. The GSP utilization rate grew from 25.4 % in 1997 to 50 % in 2003. This upward trend will continue to the point of full utilisation of GSP.

FREE TRADE AGREEMENTS

Georgia has signed a number of bilateral Free Trade Agreements (FTAs), with the members of the Commonwealth of Independent States (CIS) including Armenia, Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Ukraine. Currently, Georgia is not a party to any FTA outside the CIS.

On December 18, 2002, the Georgian Parliament ratified the GUUAM free trade agreement. The agreement on forming a free trade zone was reached at the GUUAM (Georgia-Ukraine-Uzbekistan-Azerbaijan-Moldova) Presidents' Summit in July 2001 in Yalta. The creation of favourable conditions for strengthening trade and economic links based on free trade is one of the major objectives of cooperation within the framework of this multilateral trade organisation.

EXTERNAL TRADE

Georgian exports are partially concentrated on low value-added commodities such as ferrous metals, copper, aluminium, iron and steel and mineral fuels. However, the dynamics of exports seems to indicate that the concentration of exports on low value-added commodities will decrease gradually over time.

Table 1: Trends in Georgia's Balance in Trade (recorded trade) 1994-2003

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Exports (million USD)	152	199	240	192	238	330	320	348	444
Imports (million USD)	395	687	942	880	602	651	684	731	1,058
Trade balance (million USD)	-243	-488	-702	-688	-364	-321	-364	-383	-614
GDP (million USD)	1,909	3,072	3,576	3,620	2,804	3,043	3,210	3,302	3,948
Exports/GDP	8	6	7	5	8	11	10	10.5	11.2
Trade/GDP	29	29	33	30	32	31	32	31	32.6
Trade balance/GDP	12.8	15.9	19.6	19	13	10.5	11.3	11.6	15.5

Source: State Department for Statistics

Imports are dominated by mineral products (importantly including natural gas, oil and oil products), and electricity, which indicates the dependence of Georgia on foreign energy. In 2003, imports increased by 45 % in USD terms, reflecting the need for imported goods for the construction of the Baku-Tbilisi-Ceikhan (BTC) pipeline.

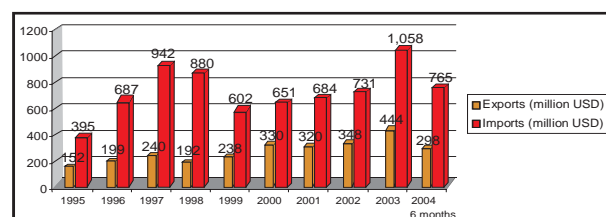
In H1 2004, exports increased by 66% compared with the same period in 2003, while imports increased by 57%. Such significant growth in trade turnover is a result of anti-corruption measures implemented by the Georgian Government, which brought about a greater legalisation of import and export flows. The share of the ten main trade partners in the total registered trade turnover was about 73.4%. The main partners in the last 10 years were Russia, Turkey, Azerbaijan, and the UK.

Table 2: Composition of Registered Exports According to the Harmonized Commodity System (By HTS 4-digit Categories, 2003)

	USD thousands	Per cent
Total exports	444,087	100
Ferrous waste and scrap: ingots of iron or steel-7204	56,461	12.7
Aircraft and parts thereof - 8802, 8803	37,441	8.4
Wine of fresh grapes, including fortified wines -2204;	36,247	8.2
Sugar -1701	30,935	7.0
Waters, including natural or artificial mineral waters- 2201, 2202;	28,884	6.5
Ferroalloys -7202	26,078	5.9
Copper ores and concentrates -2603	23,051	5.2
Gold, unwrought or in semi manufactured forms-7108	18,541	4.2
Mineral or chemical fertilizers, nitrogenous -3102.	18,466	4.2
Petroleum oils and oils from bituminous minerals, crude -2709;	15,133	3.4
petroleum oils and oils from bituminous minerals -2710;		
Other	152,850	34.4

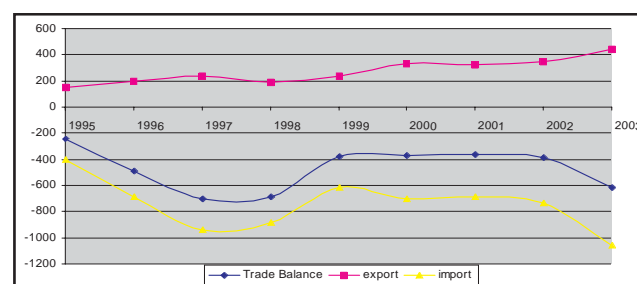
Source: Ministry of Economic Development

Chart 1: Dynamics of Georgian Exports and Imports (1995-2004)



Source: State Department for Statistics

Figure 1: Registered Exports, Imports and Trade Balance, 1995 -2003 (USD thousands)



Source: State Department for Statistics

In 2003, imports were dominated by mineral products. The figures in Table 3 demonstrate Georgia's continuing dependence on foreign energy. The import of petroleum, gases, oils, and electrical energy together represented about 18 % of total recorded imports. The import of articles of iron and steel (mainly pipes for the BTC construction) was the second largest item, with a value of USD 93.7 million.

Imports of pharmaceutical products (HTS chapter 3004) accounted for 5 % of recorded imports. The share of imported food (wheat, flour) and tobacco was slowly decreasing. Table 3 indicates that the largest imported product groups together constituted about 46 % of total imports in 2003.

**Table 3: Composition of Registered Imports
According to the Harmonized Commodity
System (By HTS 4-digit Categories, 2003)**

	USD thousands	Per cent
Total imports	1,057,793	100
Petroleum oils and oils from bituminous minerals (other than crude) – 2710	102,543	9.7
Tubes and pipes - 7305	93,723	8.9
Petroleum gases - 2711	65,994	6.2
Medicines – 3004	51,567	4.9
Sugar - 1701	50,563	4.8
Motor cars and other motor vehicles- 8703	44,516	4.2
Electrical energy – 2716	21,519	2.0
Tobacco and manufactured tobacco substitutes – 2402	19,807	1.9
Steam turbines and other vapour turbines, and parts thereof - 8406	17,721	1.7
Aircraft, powered ; spacecraft (including satellites) and spacecraft launch vehicles– 8802	16,942	1.6
Other	572,898	54.2

Source: State Department for Statistics

DIRECTION OF TRADE

The main market for Georgian products is still the CIS. Turkey is a destination for 16 % of Georgian exports. The EU's share was about same. During the past few years the CIS and the EU accounted for more than 70 % of Georgia's registered imports. Turkey accounted for another 10 %. Imports from the USA were relatively small.

Several factors and parameters related to the prospective economic development of the country provide sufficient grounds for dynamic expansion of export and import flows in Georgia. These include:

- optimistic GDP growth rates;
- suitable macroeconomic conditions;
- considerable development aid package (EU and Millennium Challenge Account packages);
- continuing support of the International Financial Organisations;
- evident trends in legalisation of the grey sector of the economy and especially trade.

However, Georgia needs to diversify its export markets, which seems eminently possible through full utilisation of its multilateral and bilateral trade arrangements as well as through the production of internationally competitive products. The role of foreign direct investment in this process is indispensable.

AGRICULTURE

GENERAL OVERVIEW OF THE SECTOR

As an ancient settled culture, Georgia has a rich tradition in agriculture. The total territory of Georgia is 69.7 thousand km², broken down as follows:

- Plains – 13%;

- Foothills - 33%;
- Mountainous area - 54%.

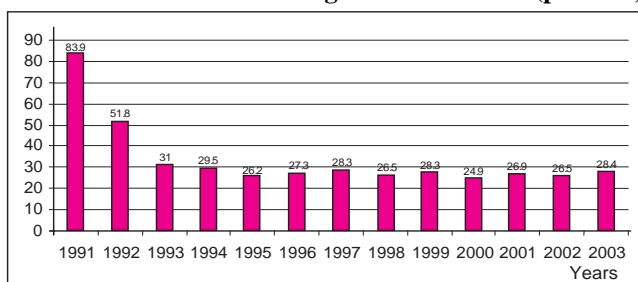
3022.7 thousand ha of agricultural land comprises:

- 795.3 thousand ha of cropland;
- 267, 9 thousand ha under perennial plants;
- 1939, 7 thousand ha of sown area and pastures.



Arable lands and woods occupy 85% of the total area. Vertical zonality with almost all types of soil and climate is typical for the country. Due to such diversity, in terms of specialization in agriculture, the territory of the country is divided into 13 zones and 6 sub-zones.

In 1991, when the sector was functioning more or less smoothly, its share in GDP accounted for about 84 %. However, besides the relative efficiency of the sector, the size of agriculture in the national economy in 1991 can also be explained by the then current collapse of the Soviet Union, which brought industry to a halt and minimized the share of the latter in GDP. Notwithstanding existing problems, in recent years the share of agriculture in GDP has been on an uptrend, making up 28% in 2003. Notably, more than 50 % of the labor force is employed in this sector.

Chart. 1. The Share of Agriculture in GDP (per cent)

Source: State Department of Statistics

PRODUCTION OUTPUT

Annual climatic conditions are favorable for the production of a variety of agricultural products in Georgia. It is rare for a small country to be capable of producing a broad range of products including grain-crops, melons and gourds, fruit, tea and citrus fruits. The wine industry – a matter of national pride for Georgians – is worthy of special emphasis. This field is based on the ancient traditional know-how and is regarded by Georgians as a part of their cultural heritage. Georgian wine, famous for its unique qualities, is well established on the international market. Animal breeding is another well-developed and growing field of Georgia's agriculture.

Table 2 illustrates dynamics of agricultural production output.

Table 2: Agricultural Products (thousand tones)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Grain&bean, total	516.2	652	902	598	773	407	713.6	680	738.7
Wheat	76.5	114	311	145	226.1	89.4	306.5	200	225.0
Maize	386.5	491	546	420	490	295.9	288.6	400	450
Haricot bean	14.3	21.7	15	9.2	9.3	2.6	10	10	9.6
Sunflower	7.1	4	31.4	22.8	40.5	2.6	41.8	20	24
Potatoes	353.3	285	353	350	433.3	302	422.2	415	424
Vegetables	428.3	386	513	380	417	354.2	396	405	430
Fruits	383.9	361	299	279	296	250	200	150	260
Grapes	422.4	311	309	238	220	210	150	80	200
Tea	38.5	86.2	33.2	47.2	60	24	23	24	25.5
Citrus	118	117.8	57.1	85.1	56	40	60	33	50

Source: State Department for Statistics

EXPORTS OF AGRICULTURAL PRODUCTS

The current export of agricultural products seems to be on an uptrend. Georgian agricultural products have their



traditional market - former soviet countries, where Georgian brands are broadly recognizable and consumer preferences in favor of Georgian products remain steady

and strong. At the same time, despite the difficulties associated with access to the western markets, some types of products have established themselves on the markets of the United States, and Western and Eastern Europe.

Table 3 reflects the diversity of both Georgian exports and imports of agricultural products.

Table 3: Georgia's Registered Exports and Imports of Agricultural Products, 2003

(USD thousands)	Import	Export
01 - Live Animals	951	45
02 - Meat and edible meat offal	13,319	412
03 - Fish and crustaceans, molluscs and other aquatic invertebrates	1,812	317
04 - Dairy produce; birds eggs; natural honey; edible products of animal origin, not elsewhere specified or included	6,235	158
05 -Products of animal origin, not elsewhere specified or included	50	0
06 -Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	174	215
07 -Edible vegetables and certain roots and tubers	2,521	300
08 -Edible fruit and nuts; peel of citrus fruit or melons	2,768	13,771
09 -Coffee, tea, maté and spices	2,165	4,527
10 -Cereals	16,857	10,671
11 -Products of the milling industry; malt; starches; inulin; wheat gluten	13,448	78
12 -Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruits; industrial or medicinal plants; straw and fodder	335	714
13 -Lac; gums, resins and other vegetable saps and extracts	349	108
14 -Vegetable plaiting materials; vegetable products not elsewhere specified or included	38	12
15 -Animal or vegetable fats and oils and their cleavage products prepared edible fats; animal or vegetable waxes	7,599	150
16 -Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	2,873	54
17 -Sugars and sugar confectionery	54,635	31,289
18 -Cocoa and cocoa preparations	10,121	845
19 -Preparations of cereals, flour, starch or milk; bakers' wares	5,208	824
20 -Preparations of vegetables, fruit, nuts or other parts of plants	3,303	1,823
21 -Miscellaneous edible preparations	4,412	508
22 -Beverages, spirits and vinegar	7,434	79,116
23 -Residues and waste from the food industries; prepared animal feed	1,945	163
24 -Tobacco and manufactured tobacco substitutes	24,520	1,486

Source: State Department for Statistics

Agriculture in Georgia, in common with other transition economies, faces the challenge of unfair international competition. Due to the policies of subsidizing and damping prevailing on their potential markets, such countries as Georgia lack the means for protecting their domestic markets. In the advent of "a level playing field" advocated by the WTO, the country will have better opportunities for the protection and development of its agribusiness.

Georgia's accession to the WTO in 2000 will be greatly beneficial, ensuring better access for its exports to international market, the elimination or softening of discriminatory trade with Georgia, the protection of the domestic market against dumping and falsification, and fair and objective settlement of disputes.

Altogether, these changes, innovations and development trends in the sector create a favorable environment for the attraction of foreign investments to Georgia.

CURRENT REFORMS IN AGRICULTURE

Through implementing a set of integrated reform policies, significant progress has been achieved in the agricultural sector. The ongoing progressive changes are likely to have a strong positive effect on agriculture in the short term. In particular, current reforms will create more opportunities and a more favorable environment for foreign direct investments in this sector. Some of these reforms that have had the strongest impact on the development of the sector deserve brief explanation:

PRIVATIZATION AND REGISTRATION OF LAND

Land reform is of paramount importance for the development of this sector. Since 1991, up to 4 million lots comprising a total area of 930 000 ha have been transferred to 1 400 000 persons. Notwithstanding privatization, approximately 75 % of agricultural land still remains under state control, including approximately 35 % of plots given on lease. A new stage in the privatization of agricultural lands that is under way will include the plots currently remaining as state property.

The law on Land Registration adopted in 1996 established legal mechanisms for the registration and private ownership of land. The process of land registration and land cadastre, supported by a number of international organizations, provides proper legal guarantees and procedures for ownership of land, and for the acquisition of reliable information on the land market in the country.

DEVELOPMENT OF THE LAND MARKET

A smoothly functioning land market is a necessary precondition for the effective use of the land resources available in the country. This reform allows for the sale of farmlands; that is, for the transfer of agricultural lands from less efficient to more efficient owners. A developed land market will undoubtedly stimulate foreign investment inflow to the sector.

TAX REFORM

Taxation, as one of the main determining factors in the business environment, naturally has a significant influence on the performance of the agro business. To this end, an important step was made towards the liberalization of the system of taxation.

Property tax on small plots of land (less than 5ha) has been abolished.

The new Tax Code provides also for the abolishment of tax on property transaction.

AGRICULTURAL INFRASTRUCTURE, SYSTEMS OF SUPPLY AND SERVICES

A modernized infrastructure is essential in order to create favorable business conditions and attract both domestic and foreign investments to the sector. At the current formative stage of modern agro business in Georgia, the government is putting significant effort into this area. Among other programs and projects, the Ministry of Agriculture in cooperation with the World Bank, is implementing a program of rehabilitation of melioration systems. It is expected that, in the short term, the participation of private owners/farmers in investments in the rehabilitation of the melioration system will increase.

One of the key aspects of the development of agricultural infrastructure is the introduction of technically modernized, state-of-

the-art, highly efficient and energy-efficient agricultural machinery. For the development of private investments in this direction, the government supports the wide application of leasing in the acquisition of the means of production.

Agriculture in Georgia is growing steadily. Recent reforms on land privatization, registration, development of infrastructure, accession of the country to the WTO and etc., have already yielded positive results, such as increasing the share of agricultural goods in GDP, and growing exports. A favorable basis for the full realization of the potential of this sector and the attraction of both internal and external investments has been formed. This in turn is facilitating the process of returning traditional niches in foreign markets and developing new markets. The potential efficiency and the needs of this growing sector, especially at the current formative stage of modern agro business in Georgia, offer many opportunities for foreign investors.



GEORGIA'S TOURISM

– *Invest in the country where nature has invested too.*

“Wherever we had been in Russia, the magical name of Georgia, came up constantly.

People who had never been there, and who possibly never could go there, spoke of Georgia with kind of longing and great admiration. They spoke of Georgians as supermen, as great drinkers, great dancers, great musicians, great workers and lovers. And they spoke of the country in the Caucasus and around the Black Sea as a kind of second heaven”.

This paragraph taken from the article in a Russian journal by the American writer John Steinbeck was written about fifty years ago. At that time Georgia's status amounted to the most attractive destination in the former Soviet Union – a sort of Switzerland and also Rivera for Soviet people, for whom the rest of the world had been closed by the “Iron Curtain”.

In those days Georgia had very little accessibility to the international market. However, the number of tourists arriving in Georgia took 3rd place after Russia and Ukraine. With an accommodation capacity of 44 500 beds in 1989, Georgia generated 1 800 000 tourists, of which 280 000 were from non-Soviet countries. At that time 40% of all foreign tourist itineraries within the USSR passed through Georgia.



In those days, tourism was regarded as a priority in the strategic economic plan for Georgia, as is now the case again today.

Unfortunately, back in the early 1990s, Georgia did not achieve its independence from the Soviet Union smoothly. A brief civil war and the subsequent social, political and economic turmoil devastated one of the most developed tourism infrastructures in the former Soviet Union.

Historically, Georgia has existed as a shadow – albeit a bright one – within the Russian and then Soviet empires. It has been forced to hide from the rest of the world for almost 200 years – and so today has work to do in order to raise its profile onto the international stage. Georgians know their country deserves a significant position on the world tourist map – now they are beginning the task of making this happen. Georgia, located on the edge of Europe, has a fundamentally European culture, the flavour being essentially

Mediterranean in style.

Firstly, the message must be spread that this beautiful, ancient country is not only exceptionally hospitable, but is also safe for tourists over nearly all its territory – contrary to some reports.



Without doubt there are tens of thousands of tourists and travellers across the globe whose “explorer” curiosity should bring them to this charming “terra incognita”. They will find that Georgia's infrastructure is now developing rapidly. With a new visa policy and increasing transportation access (air, land and sea), combined with a new, firm commitment to safety, Georgia is ready to welcome a new culture of tourism.

As tourist destination Georgia has so much to offer:

Fantastically Diverse Nature. With a territory of 64 700 Sq. KM. Georgia includes 330km of subtropical Black sea coast, extensive agricultural regions and alpine valleys with dramatic mountains such as Shkhara (5198m) and Kazbek (5 033m). 38,6% of the country is forest. It has 19 nature reserves, 860 lakes, numerous



waterfalls and more than 25 000 rivers whose total length is 54 768km.

Numerous Historic Monuments and a Rich Ethnographic Resource. Georgia has 12 000 historical monuments and 150 museums; medieval towers pepper



the sub alpine zones, and some of the cathedrals, churches, monasteries and bridges date as far back into the past as the VI-V millennium B.C.

Resorts and mineral springs. The diverse climatic conditions in Georgia give a tremendous potential for tourist resort development. Already there are 2000 mineral springs, producing over 130 million litres per day.

Folklore and Ancient Custom. The culture and traditions of Georgia are both Oriental and Occidental, a combination of Europe and Asia. The higher mountainous regions have remained largely unaffected by modern civilization, and local people maintain ancient customs, craftsmanship, hospitality and the tradition of toast-making at *supras* – or feasts.

Undisturbed endemic Flora and Fauna. The Georgian countryside is unusually well preserved and rich in diversity. Endemic Flora and Fauna remains of great interest both to scientists and tourists.

Food, Wine and Georgian Cuisine. Georgia, the country that invented wine, today produces more than 250 fine wines. Both delicious and ecologically sound, most of the food in Georgia is organic. The cuisine is unique and the subject of many books and articles – as are the songs and traditional toasts that make the Georgian table an unforgettable event.

Hospitality. This is a fundament of Georgian culture, which affects every facet of life. The guest is considered to be a ‘gift from God’ – and quite rightly so. For Georgians, being host is not only an honour but also a real pleasure, and continues a centuries-old tradition.

Activities relating to tourism in Georgia include the following:

- Cultural tourism: archaeology, history, agriculture, ethnography;
- Adventurous tourism: trekking, mountaineering; skiing, horseback riding; mountain-biking etc.;
- Eco Tourism (Bird watching, Botany, Active Eco tours;
- Agro Tourism;
- Special interest tourism (wine and gourmand tours, photography, etc.);
- Resorts and recreational tourism;
- Conventions and Conferences;

The new face of tourism in Georgia now offers great opportunities for investors. These include hotels and other



accommodation facilities, catering, transportation, communication, information technologies, convention facilities, sport and recreation facilities, as well as financial services. In fact every field of tourism-related business is now looking for investment and expertise.

Now is the time to invest in Georgia; to be the first to benefit from the launch of a whole new tourism industry – a process which is already under way. Georgia has dedicated itself to developing a fast growing demand – which cannot fail to bear fruit in the coming years.

Now is the start of a joint success story.

A PERSONAL VIEW

– BY THE BRITISH WRITER *PETER NASMYTH*

When the organizers of the Conference *Invest in Georgia* asked me to write piece on tourism in Georgia – I first thought no. My role isn't as spokesperson or employee for anyone. My role is as independent, free agent that the general public must trust. Then it occurred – that actually we are both trying to do exactly the same thing – and for many years, but with limited success. The only difference is Georgians operate from the inside – I from the outside. Furthermore although I carry no political agenda and never will – both of us do share the same unshakable belief that Georgia is certainly the most dramatic, undiscovered and beautiful country for its size in the world. indeed I've been trying to broadcast this fact for the last 15 years in my various books, articles and photographs.

But still Georgia has a problem. Very few people in the outside know it as a tourist destination – in spite of its primary role as such in the Soviet union. Much of the public information and international news is not helpful – and recently Georgia has been tarred with the same brush as Chechnia and North Ossetia. But this is like saying that all of England suffers the same problems as Northern Ireland.

This is almost a crime of public information. Those of us who know this country well – have never been put off by incidents across its borders. Even the 'risky' zones inside Georgia, like the Kodori or Pankisi valleys, have almost no effect on the reality of life in the country. Recently I've been traveling frequently to upper Svaneti – a quite breathtakingly beautiful region connected to Kodori – without any problems, in spite of the warnings on various government web sites. Another mountainous region – Tusheti – that borders with Chechnia, I consider one of the safest parts of the Caucasus region. All you need is common sense – and the tourist will have a most exceptional time.

I've now started writing two new books – one a photographic revelation of the fabulous landscape of the Caucasus (unknown to most of the world). The second is a walker's guide to Georgia – this in the firm belief that numerous walker will be coming here in the relative near future. They have a great treat in store – mountains higher than the Alps and more dramatic. Mt. Ushba, the Matterhorn of the Caucasus, has two peaks not one. The walks around it are quite unforgettable – and much any in the world. Even the Svans who live in this region, with a reputation for a character that

matches their severe climate – give out a hospitality that is Asian in its richness, but in a culture that is Christian. The Svans churches are mostly 12th century with frescos from the same period stretching floor to ceiling. The cathedrals in Georgia's low lands are the same – only bigger.

The mountains that wrap around the country of Georgia are a unique resource that should be preserved – but also opened up to the wider public. Svaneti had no more than 200 foreign visitors this summer. The Kazbegi region, with its huge mountain (where Prometheus was reportedly chained) is just three hours from Tbilisi. Gudauri with fan-

tastic walks (and skiing) beginning at 2000 meters is just one a half hours along the newly re-paved road. The people who live up in these regions are delighted to welcome tourists – indeed they need us.

The only counter I've seen whose mountains are more impressive than Georgia's is Nepal – but Nepal has no sea, no wine district, no semi-desert. Furthermore the high Caucasus is quite

different in style, both to there and the alps. It belongs to a separate zone and is effectively 'Europe' – a mere four and a half hours from London – but with an Asian flair.

I believe that Georgia's tourist potential is not only enormous – as witnessed by its huge popularity during the Soviet period – it is also a vital ingredient in the country's regeneration following its rose revolution last year. Much has changed – and the arrival of tourists would continue this, very much for the better. We have seen this in other countries. The Georgian government has pledged itself to looking after the security of tourists. If they fulfill this promise – and they have certainly started well in Svaneti – then the tourist will be back in Georgia, as I remember them in the Soviet time.

In my first book I wrote about walking down Tbilisi's Rustaveli Avenue and being taken as a Russian tourist – with my blond hair. I appeared then as just one of the many from Eastern Europe. Now it's the turn of Western Europe. When we opened our bookshop on the same street, 'Prospero's,' five years ago – we envisioned this new beginning. Its been slow, but it is coming. Change is in the air in Georgia...



Peter Nasmyth's current book is 'Georgia, in the Mountains of Poetry' published by Routeledge Curzon.

LIVING IN GEORGIA

Local time: GMT/UTC + 3 hours

Electricity: 220 Volt, 50 Hz

The system of weights & measures: metric

GETTING THERE

Regular direct air connections to Tbilisi are available from Amsterdam, Athens, Berlin, Frankfurt, Istanbul, London, Moscow, Paris, Prague, St. Petersburg, Vienna and Zurich.

Useful telephone numbers:

Tbilisi Airport - (995 32) 443 12; (995 32) 433141

Taxi - (995 32) 433141

VISAS

Procedures for obtaining entry visas to Georgia have been simplified. Visas can be easily obtained either at the Consular offices of the MFA located in 30 countries, or on arrival at Tbilisi international airport. In addition, Georgia has also trimmed down the prices for visas. A one-month visa will cost USD 10; three-month – USD 30 and an annual visa USD 100. Tourists entering Georgia by sea will be able to travel across the country without a visa for 72 hours.

There are no visa requirements for the citizens of the Republic of Armenia, the Republic of Azerbaijan, the Republic of Belarus, the Republic Kazakhstan, the Kyrgyz Republic, the Republic of Moldova, the Republic of Tajikistan, Ukraine, the Republic Uzbekistan, the Peoples Republic of China, the Republic of Hungary, the Islamic Republic of Iran, Romania, the Slovak Republic, the Republic of Turkey, Turkmenistan, and the Republic of Bulgaria.

MONEY AND BANKING

The national currency of Georgia is the Georgian Lari, which consists of 100 tetri. The exchange rate as of autumn 2004 is 1 USD=1.80 – 1.85. Payments are mostly made in cash. However, more and more shops, restaurants and hotels accept credit cards and cheques. There is a wide range of banks functioning in Georgia, with branches and ATMs. They are open from Monday to Saturday (working hours on Saturday are 10.00 – 15.00).

Each bank has its own individual work-schedule. Exchange offices at the airport and railway stations offer around-the-clock service every day, while in the main streets of the capital city they are open from 10.00 – 18.00.

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ACCOMMODATION AND HOTELS

Most of the accommodation facilities currently available in Georgia are bed & breakfast type smaller hotels and guesthouses typically serving eight to sixteen guests. As a rule these are family-operated hotels that provide a comfortable interior, good food, laundry and Internet access – all with the charming element of personal hospitality. Four five star hotels are an alternative to the small hotels.

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ENTERTAINMENT AND LEISURE

Tbilisi – the city that for centuries amazed travellers with its unique comfortable spirit – is becoming more and more of a nightlife city. Here are some of the most popular places to relax:



GMC GROUP - best quality service for you.

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Restaurant DZVELI SAKHLI - looks like a mini ethnographic museum with picturesque surroundings.

3 Sanapiro st., Tbilisi 0112, Georgia
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Restaurant MATRIOSHKA - Russian cuisine and sense of the real Russian spirit. The parties and show-programs of romances, folk songs and dance.

The Heroes Square.
 Tel.: (995 32) 995 778; (995 77) 505 516

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Restaurants TOKYO and SAKURA - Japanese exotic atmosphere especially for you to relax.

Taste Sushi - the healthful food to be more graceful and healthy.

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